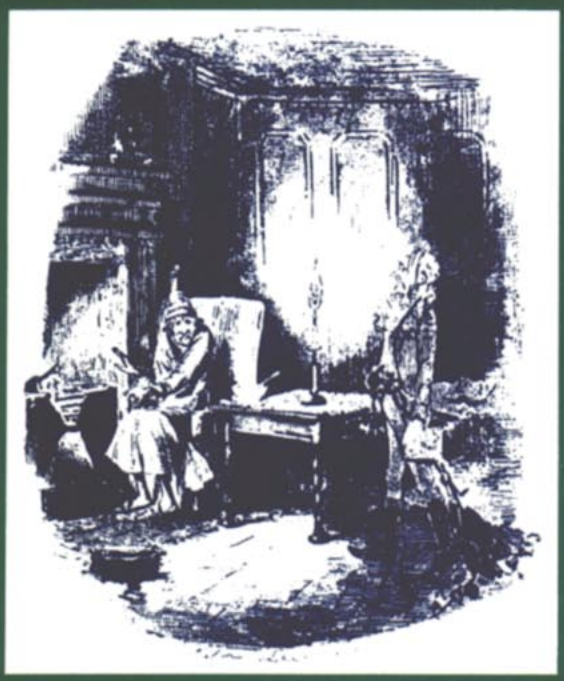
THE FREEMAN

IDEAS ON LIBERTY



Ebenezer Scrooge and the Free Society

How to Solve the Debt Crisis

The Liberating Arts

DECEMBER 1988

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THE FOUNDATION FOR ECONOMIC EDUCATION, INC.
Irvington-on-Hudson, New York 10533

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The Freeman considers unsolicited editorial submissions, but they must be accompanied by a stamped, self-addressed envelope. Our author's guide is available on request.

PERSPECTIVE

Freedom's Child

Walter and I were very lucky. Our *babunia* (grandmother) never worked. She was always at home, so we never had to go to the government kindergarten, the *sadochok,* which begins when a kid is three years old. Babushka taught us our ABCs, addition and subtraction, before we went to the first grade.

She told us the Bible stories she knew. Where there are no Bibles, the only way you can learn to know the Lord, to know what God is about, is to talk.

You spend time with your grandmother because you love her and listen to her and you learn what's true and what isn't. Then you go to school six days of the week, from nine in the morning to three in the afternoon, listening to the teacher and learning to become Young Pioneers, and then you join the League of Young Communists, the Komsomol.

So you become in-between. You just don't know what's right. For a certain period of your life, you go through a stage like being lost.

Finally, you really have to decide what you believe. You either become a person of your own—you learn things within your family and its beliefs, and you believe in them—or you are pulled into the society. Either you become a Christian, a believer in God, or you become the absolute opposite.

In the Soviet Union, everything is against God, against religion, against Christianity. Everything is for Communism. But Communism doesn't work. So this contradiction makes you think, question things. You press for answers and you have to guess for yourself what they are.

But we were lucky. We had our *babunia*. She taught us everything she knew about God, and about believing in Him and in knowing what was right.

—NATALIE POLOVCHAK WILCOXEN,
writing in *Freedom's Child,*
by Walter Polovchak (Random House, 1988),
a book which relates the story of young
Walter's defection from the Soviet Union.

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Marxism Is Dead

The Communist Manifesto, published in 1848, is a clever piece of literature aimed at curing all the ills of society created by class antagonisms. With this taken into consideration, there is no denying the appeal of the communist "perfect society"—an end to exploitation, alienation, and human suffering. But Marx and Engels were wrong.

They asserted that "Society as a whole is more and more splitting into two great hostile camps, into two great classes facing each other —bourgeoisie and proletariat," and with an increase in class antagonisms there eventually would be a social revolution which would crush the bourgeoisie and create a "perfect society." Marx and Engels, however, turned out to be poor prophets. Instead of an increase in class antagonisms between the bourgeoisie and the proletariat, there has been a decrease. The reason for this is the capitalist revolution. Capitalism has provided a better standard of living and general well-being for the masses than Marx or Engels could ever foresee—and it shows no signs of decaying.

But is man better off? Has capitalism "left no other bond between man and man than naked self-interest, than callous 'cash payment,' " and "reduced the family relation to a mere money relation"? The capitalist society can be callous, and certain characteristics of the bourgeoisie often are contemptible, but with the proper institutions—especially family and religion—the vices of a free market society can be restrained and transcended, leaving more to life than "naked self-interest." *The Communist Manifesto* falls apart at this point and the authors' attempt to discredit religion and family turns out to be lame.

So who believes in Marxism? Is it an ideology for all nations as Marx and Engels claimed? History once again proves them wrong. There has yet to be a country which has experimented with Marxism and carried out its agenda word for word. Lenin ran into the problems inherent in strict Marxism and experimented with a limited market system—the New Economic Policy. China has been moving away from strict Marxism, as have several nations in the Soviet Bloc. It is evident that Marxism is fatally flawed, and except for a few godless radicals who naively hold to this ideology, it is dead.

—Robert Jordan
Florida State University

Soviet Awakening

It is time to stop deceiving ourselves, stop believing the office ignoramuses and calmly admit that the problem of "consumer selection," the problem of competition, is not rooted in any social or class relationships. . . .

Bottom-line, market stimuli must extend to all stages of the process "research-development - investment-production - marketing-service." Only the marketplace, and not mere administrative innovations, can subordinate this entire chain to the demands of the consumer.

—Nikolay Shmelyov
writing in the June 1987 issue
of the Soviet journal, *Novy Mir,*
as reported in the Montreal *Gazette*
(July 6, 1987)

Felix Morley Prize Winners

We are pleased to note that five young *Freeman* authors have been honored in the 1988 Felix Morley Memorial writing competition sponsored by the Institute for Humane Studies. Our congratulations go to Christopher L. Culp, Nick Elliott, John Hood, Philip S. Smith, and Robert S. Taylor. It has been especially gratifying for us to work with such promising young writers.

—Beth A. Hoffman & Brian Summers

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THE FREEMAN
IDEAS ON LIBERTY

Ebenezer Scrooge and the Free Society

by Howard Baetjer Jr.

Behaving in a self-interested manner does not mean disregarding others. On the contrary, because we are social beings who depend on, and often care deeply about many others around us, a sound attention to our self-interest must include a great deal of concern for others.

However true we may see this to be on a moment's reflection, many of us often lose sight of it, especially in our political and economic thinking. Particularly in regard to the free economy, a vague equating of selfishness and capitalism often infects people's thinking. The very word capitalism brings to many minds grim visions of ruthless characters damning the public interest or selling their mothers for farthings.

The archetype of the antisocial capitalist is Ebenezer Scrooge of Charles Dickens' classic tale, "A Christmas Carol." In Dickens' words, "Oh! But he was a tight-fisted hand at the grindstone, Scrooge! a squeezing, wrenching, grasping, scraping, clutching, covetous old sinner! Hard and sharp as flint, from which no steel had ever struck out generous fire; secret, and self-contained, and solitary as an oyster."

As many who attack the market would have it, Scrooge embodies the spiritual ruin of capitalism; he is the type toward which all capitalists tend. Indeed, I have a dear friend who jibes at my free market sympathies by quoting Scrooge's attitude about Christmas donations for the poor: "Are there no prisons? Are there no workhouses?"

It is as if he believes that supporting the free market means forswearing kindness, as if simply entering the competitive whirl of business contaminates individuals with an attitude of competitiveness—or rather of strife—that poisons their relationships, distorts their perspective, and destroys their feeling for the brotherhood of man.

The widespread notion that free markets are corrupting is rooted at least in part in the innocent truism that for the market to work people must act according to self-interest. Without the motivation of self-interest, there would be no profit seeking, no price competition, no production and exchange. True enough, the market requires self-interested behavior.

But many make an illogical leap from this truism to a falsehood: that if one is self-interested, one cannot be other-interested. Many see an either/or choice. Scrooge can care about Scrooge, or he can care about others: the poor, his clerk Bob Cratchit, Cratchit's family, including lame Tiny Tim, and so on. He cannot do both.

Supporters of economic liberty will win to their cause very few people who believe in this notion. As long as they see self-interest to be at odds with cherished values of generosity and fellow-feeling, people will not embrace a polit-

Mr. Baetjer, a former member of the FEE staff, is a doctoral student at George Mason University, Fairfax, Virginia. *This essay originally appeared as a chapter in* Ideas on Liberty: Essays in Honor of Paul L. Poirot, *published by FEE.*

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ical economy based on self-interest. Thus a task for lovers of liberty is to point out that self-interest and interest in others are not at odds, that in fact they go together.

They do. In fact, that is one of the main lessons "A Christmas Carol" teaches. The point of the story is that Ebenezer Scrooge, the archetypal "greedy capitalist," becomes immeasurably happier when and because he gives up his selfishness and becomes generously involved with those around him. There is no suggestion that he gives up his capitalism; in fact, Dickens tells us that he is at his desk early the day after Christmas. He just broadens his other activities and ends.

A quick recapitulation for those who may have forgotten the story: After refusing his nephew's invitation to Christmas dinner, refusing to donate anything to a Christmas fund for the poor, driving away a boy singing Christmas carols, and only grudgingly granting Bob Cratchit Christmas Day off, Scrooge goes home to a harrowing night. He is visited by the ghost of his old partner, and then in succession the ghosts of Christmas Past, Christmas Present, and Christmas Yet To Come. The ghosts open his eyes to the joy of his past Christmases, the opportunities he is missing in this one, and the unhappy end he faces if he keeps on his present isolated course. The next day, joyous that he can change the future by changing his behavior, he sends a prize turkey to the Cratchits, promises a large gift to the fund for the poor, goes to dinner at his nephew's, and generally enjoys himself hugely. Afterward, "it was always said of him,

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that he knew how to keep Christmas well, if any man alive possessed the knowledge."

Scrooge's Mistake

This lovely tale emphasizes a point about economic man that is of overriding importance to the spiritual case for liberty. That is, maximizing money income is quite a different thing from maximizing well-being. For all his profit motive, Scrooge before the ghosts' visits is not acting to "maximize his utility," in the economists' term. In his mania for money, he is a cold, loveless, bitter man. In economic terms again, the opportunity cost of his ceaseless accumulation of assets is the far greater wealth in "psychic income"—pleasure—that he forgoes. No doubt Scrooge is doing what he perceives to be in his self-interest—each of us is *homo economicus* to that extent—but as the ghosts show Scrooge, he is making catastrophic mistakes.

As he hears his nephew say, at Christmas dinner in the dream, "the consequence of his taking a dislike to us, and not making merry with us, is, I think, that he loses some pleasant moments, which could do him no harm. I am sure he loses pleasanter companions than he can find in his own thoughts, either in his mouldy old office, or his dusty chambers." Scrooge loses music, laughter, blind-man's buff and other games. He loses all sorts of things that, as he observes them by the Spirit's side, have tremendous appeal. His maniacal attention to money simply cannot be called self-interested.

The next day Scrooge leaves his ledgers behind for once and goes unexpectedly to his nephew's house. Christmas dinner transpires as he had seen it in the dream, except that now he participates: "Wonderful party, wonderful games, wonderful unanimity, wonderful happiness!" He has progressed from unhappiness to happiness in an evening, thanks to a change in focus from narrow money concerns alone to a broader concern that includes the rewards of positive human relationships.

A related point is that among the greatest psychic satisfactions available to human beings are those that come simply from doing something for others we care about. I would not be misunderstood here: I am not talking about any benefit to those we care for, but just about the benefit to ourselves—the happy satisfaction, the warm glow, the serene contentment for us—that comes as a result of benefiting others.

It is rather like a pure market exchange: there is benefit on both sides. Scrooge, newly concerned for the bravely struggling Cratchit family, gives them a prize turkey. They benefit thereby; indeed, they are probably transported with delight. But they don't benefit any more than Scrooge. For him the cost of the gift is only the price of the turkey, while the benefit to him, the psychic return in joy, is, well, let us get it exactly: " 'I'll send it to Bob Cratchit's,' whispered Scrooge, rubbing his hands, and splitting with a laugh. . . . The chuckle with which he paid for the turkey, and the chuckle with which he paid for the cab, and the chuckle with which he recompensed the boy, were only to be exceeded by the chuckle with which he sat down breathless in his chair again, and chuckled till he cried."

Because others are important to us, it is in our own self-interest to give some attention to their well-being and, putting it impersonally, to invest in our relationships with them. These considerations apply beyond family and close acquaintances to the communities of which we are a part. Because we do live in our communities, community morale and standard of living have a bearing on our own quality of life. Hence it is self-interested to pay attention to the community and do what we reasonably can to improve it.

The Ghost of Christmas Present faces Scrooge with this in the persons of two children that cling to his robes:

> They were a boy and a girl. Yellow, meagre, ragged, scowling, wolfish; but prostrate, too, in their humility. . . . "They are man's," said the Spirit, looking down upon them. "And they cling to me, appealing from their fathers. This boy is Ignorance. This girl is Want. Beware of them both, and all of their degree. . . ." "Have they no refuge or resource?" cried Scrooge. "Are there no prisons!" said the Spirit. . . . "Are there no workhouses?"

Here we must be careful to grant the validity of

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Dickens' point without guessing at his policy prescriptions. Experience with the Poor Law in his time, as well as many years of experience with the modern welfare state, show how very difficult it is to help poor people. Often the effort to do so, especially in a bureaucratic structure that operates by rule rather than by judgment about individual needs, creates disincentives to self-help, and thereby perpetuates poverty. The workhouses which Dickens hates were a government effort to care for the poor. The best we can do for such unhappy souls may well be not to give them much, but rather to work for the repeal of bad laws which obstruct their advancement. In any case, the point remains that since our lives and fortunes are tied up with theirs, it is in our self-interest to do what we may to improve their quality of life. Charity can be at once generous and self-interested.

The Importance of Spiritual Goods

Another lesson of "A Christmas Carol" that can fortify the spiritual case for liberty is that material goods are often a prerequisite for spiritual goods. We tend sometimes to think that there is an either/or choice among these, too. Either we concern ouselves with "higher" matters of love, community, and doing well by others (good!), or we concern ourselves with the "low" business of producing and accumulating physical stuff (bad!).

But we are creatures of flesh and blood as well as of spirit, and we must be fed, clothed, and sheltered adequately if the spirit is to soar. We can do little for others or ourselves if we lack the means to do it with. And ultimately all money—indeed, all material goods—are means to spiritual or psychic ends. We don't want them for themselves, but for the satisfactions they can give. Scrooge discovers during the ghosts' visits that his piles of wealth are valueless to him if all he ever does is pile up more. Not until he uses his money does he "cash in" on the psychic satisfactions that are the point of the whole endeavor.

Consider the story's final episode, when Scrooge reveals his changed self to Cratchit. He says earnestly:

> "A merry Christmas, Bob! . . . A merrier Christmas, Bob, my good fellow, than I have given you for many a year! I'll raise your salary, and endeavor to assist your struggling family, and we will discuss your affairs this very afternoon, over a Christmas bowl of smoking bishop, Bob! Make up the fires, and buy another coal scuttle before you dot another i, Bob Cratchit!"

Good for generous Scrooge! His attention now encompasses the "higher matter" of his clerk's well-being. (By the way, observes the economist, Cratchit's productivity will probably increase substantially.) But how could Scrooge be generous without his cash? What would pay the higher salary, go to assist the family, buy the Christmas bowl and extra coal? Praise the Lord for Scrooge's money and his ability to earn it! May he continue to do so! It's cash that lets a generous impulse become a generous deed.

Now of course I don't mean to imply that in a free economy all will realize the extent to which their happiness increases by generous concern for others. Certainly in a free society some people will choose a low, selfish, small-spirited, narrow way of life. Surely they will be less happy because of this choice than they would otherwise be. And not all of them will have Scrooge's good luck in being brought back to his senses by the intervention of kindly Spirits of some kind. This is to be lamented.

But this unfortunate choice of a less happy rather than a more happy way of life is just that—a choice. It is not caused by the free society which allows it; it is caused by the individual's own short-sightedness, unwisdom, and inability to perceive that real self-interest depends substantially on other-regarding activities.

The good life involves a judicious balance of self- and other-regarding activities. When the balance is a healthy one, these two reinforce each other and merge. The wonderful thing about the free society is that it allows human beings such broad scope in which to pursue and fulfill all their values, whatever they may be—material, personal, spiritual—and puts in our way an abundance of resources and opportunities with which to pursue them all. □

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The Liberating Arts

by Edmund A. Opitz

The recent movie called *Out of Africa* has acquainted millions of Americans with the name of a Danish Baroness Blixen, whose pen name was Isak Dinesen. The movie is based on Dinesen's 1938 book, a semi-autobiographical work called *Out of Africa*. Four years earlier, in 1934, Isak Dinesen had published a work entitled *Seven Gothic Tales*, really seven short novels within the covers of a single book. One of these Gothic tales was set in the Paris of several generations ago and consisted mainly of the reminiscences of an old gentleman. There is a story within this larger story involving an Armenian organ grinder and his pet monkey. Some of you may recall seeing this type of street musician who would wander through city neighborhoods carrying, slung over his shoulder, a kind of music box the size of an accordion, a crank on its side. This contraption was set atop a pole, which supported the weight of the music machine when the man stopped to perform. The man would be dressed in a sort of gypsy costume, and as the entertainer cranked out his tunes his little capuchin monkey would pass through the crowd collecting coins, which he'd turn over to his master. This in itself was quite a stunt; but this little monkey was cleverer than most of his kind, because his master had taught him to perform a great variety of crowd-pleasing tricks, each one triggered by a word of command—in Armenian.

The Reverend Mr. Opitz is a member of the staff of The Foundation for Economic Education and is the author of the book Religion and Capitalism: Allies, Not Enemies. "The Liberating Arts" *was presented as a FEE Seminar lecture in Alderbrook, Washington, earlier this year.*

The Armenian died, and the little animal came into the possession of a kindly French couple who housed the monkey and fed him well. Time passed, and although the animal was properly cared for, he languished; he seemed to know that he had talents lying dormant which no one knew how to bring out. There was no one to voice the magic Armenian words. Lots of potential talent was trapped inside the little beast, but no one knew how to release it; the key had been lost.

It is my guess that Isak Dinesen intended this little story to be a parable of the human condition. Translate the parable and it suggests that individual men and women are loaded with potential talents of all sorts—talents unlimited—but these potentialities are locked up inside us and become actual only when touched by a magic wand from without—the magic wand called "education."

The scholastic curriculum labeled "liberal arts education" emerged, developed, and grew —in the course of centuries—in order to give the young people of each successive generation the tools of learning, tools which they could then use to free themselves from the hindrances and obstructions, the ignorance and taboos which prevented them from becoming the kind of persons they had it in them to be. The "liberal arts," in other words, were the "liberating arts"; they freed the individual person from all that prevented him from realizing his full potential. The ultimate goal of liberal education is wisdom and understanding—a broader and deeper understanding of human nature and the human condition, and a few clues as to the pur-

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poses of our earthly pilgrimage. Education deals with the goals of life; it is "ends oriented," and its primary tools are language, literature, philosophy, history, and mathematics.

Education and Training

Education is not the same as training. Training has to do with "how-to" knowledge, with practical instruction; training is what might be called "instrumental" knowledge. Training deals with means rather than with ends—ends being the province of education. The world could not continue on its course without the help it gets from the millions of trained men and women who accomplish the world's work—the scientists, inventors, entrepreneurs, engineers, and technologists; the doctors, dentists, nurses, manufacturers, managers, and so on. If asked to name an American exemplar of the trained man, most of us would mention someone like Thomas Alva Edison. Edison's kind of genius has given us inventions which have transformed life in modern societies in many beneficial ways; our life is cleaner, brighter, healthier, more convenient—and noisier—because people like Edison have lived and worked. We have many more things; sometimes it seems that gadgetry almost overwhelms us!

Virtually everyone acknowledges the important contributions of trained people; they keep our society going, and they make it better. They have enormously increased the number and potency of our means; enormous power is now at our disposal. But what about the people who are schooled merely in the liberating arts; what role might they aspire to play in our culture? If students have been exposed to the best that has been thought and said about man, the human species, so that they have some understanding of what it means to be a person, some understanding of the nature, destiny, and proper end of a human being, then—if such people are heeded by those with know-how and power—we might yet scrape together sufficient wisdom to save our society from being fragmented by the detonation of its newly released energies. It seems to be our fate to live at a time in history when enormous power is in our hands but barely under our control. Ideas still rule in human affairs and we won't know what to do with our recently acquired powers until we have decided what to do with our lives. And that is where the liberating arts come in, for it is a main function of a liberal education to help us face up to the question of how to make our lives count for the things that really matter.

Education and Schooling

I have briefly drawn a distinction between education and training and I shall now draw an equally important distinction between education and schooling. No society before our own has ever put so much faith in schooling, which we usually mislabel "education." Virtually no child in America lives beyond the reach of his local public school and every child's exposure to public schooling is compulsory. A few generations ago schooling at the college level was deemed a rare privilege; but now there are as many local community colleges as there once were high schools; the college population in this nation has exploded during the past generations while the curriculum has been downgraded. We proudly point to our vast network of schools and colleges as our "educational establishment," when it is no such thing. Education does occasionally occur in our schools and colleges, but it is rare to find a student who is really educable. In one of Will Durant's early books, written in 1929, he mentions a foreign student who came to this country to get a graduate degree at one of our great universities. Shortly before he returned to his native land the young student summed up his experience by declaring: "American universities are really athletic institutions, with opportunities for study for the feeble bodied."

My remark a moment ago that only the occasional college student is really educable may sound arrogant and elitist. But it wouldn't have sounded at all elitist if I had referred to the occasional educable student as a bookworm! It's a fact; liberal arts education is primarily for bookworms—a bookworm being defined as a kid who's mesmerized by the printed page. The liberal arts scholar frequents the library, not the laboratory; he gets his education by studying the books and papers written by other scholars.

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And a liberal arts scholar is the kind of person who does quite well in the typical IQ test, the Stanford-Binet test, for example. I would point out to you that what is measured by the typical IQ test is not the only kind of intelligence human beings possess; but it *is* one kind. The results of an IQ test predict reasonably well how the individual would fare in a typical liberal arts curriculum. But that's it!

Many years ago when I was studying in Berkeley at the Pacific School of Religion our psychology teacher was the head of the psychology department at the Univerity of California. Of course he had to expose the theological students to an IQ test. As it turned out we did reasonably well, having an average IQ score of over 130 compared to the average of the graduate students at the University next door of about 120. Does that mean that we were smarter than the students at U Cal? Not at all. It simply means that we had a different knid of smartness than the graduate students in physics, or chemistry, or geology, or astronomy; our forte was book learning, their intelligence was of another species. The modern world has suffered unduly from its failure to understand important distinctions in this area of schooling. We exhibit a weak understanding of the role of the liberal arts program—it's not for everyone—and we extravagantly over-value the figures obtained by IQ testing.

We began about a hundred and fifty years ago to set up a vast system of compulsory public instruction in this country. With the centuries-old liberal arts tradition in mind we geared our school system into the three R's—Readin', 'Ritin', 'n' 'Rithmetic. This was a system well adapted to bookworms; it prepared them to enter one of our liberal arts colleges. But it was not adapted to the youngsters whose intelligence ran in the direction of vocational and technical training. School, for them, tended to be a frustrating experience.

Come down to the period after World War II when someone decided that everyone ought to have a college education. There was a vast expansion of the student population. Teachers in great numbers were needed and hired, but only a few men and women in each generation have a true vocation to teach, and only a few students have a vocation for a liberal arts education. There was bound to be trouble. Trouble came, and it turned many campuses into what resembled battlefields. Our first mistake was to set up a system of compulsory public instruction, and then we compounded this error by refusing to recognize the important distinction between education and training.

Needed: Talents

A complex modern society needs a great diversity of talents, and not all talented people, by any means, are good material for a liberal arts education. As a matter of fact, no society can absorb more than a tiny percentage of people with a liberal arts Ph.D.—too many liberal arts doctors will ruin any society! But no society can have too many honest craftsmen and artisans . . . butchers, bakers, candlestick makers, and all the rest. The head is important; the hands are important. More important is the proper balance between them. Listen to John Gardner on this point: "The society that scorns excellence in plumbing because plumbing is a humble activity, and tolerates shoddiness in philosophy because philosophy is an exalted activity, will have neither good plumbing nor good philosophy. Neither its pipes nor its theories will hold water."

This lack of balance was perceived by an astute French critic, Ernest Renan, more than a century ago, but we did not heed his warning: ". . . .countries which, like the United States, have set up considerable popular instruction without any serious higher education, will long have to expiate their error by their intellectual mediocrity, the vulgarity of their manners, their superficial spirit, their failure in general intelligence."

Every one of us has encountered persons of enormous energy and enthusiasm; bursting with ideas which sound plausible but whose projects fizzle out without getting anywhere. I once knew such a man. He had written a widely noticed book during the thirties, and since that time had started numerous organizations to save the world. The world persistently refused the offer. Discussing the matter with a friend some years ago I wondered aloud why so-and-so had never gotten himself off the ground. "The trouble with him," said my friend, "is

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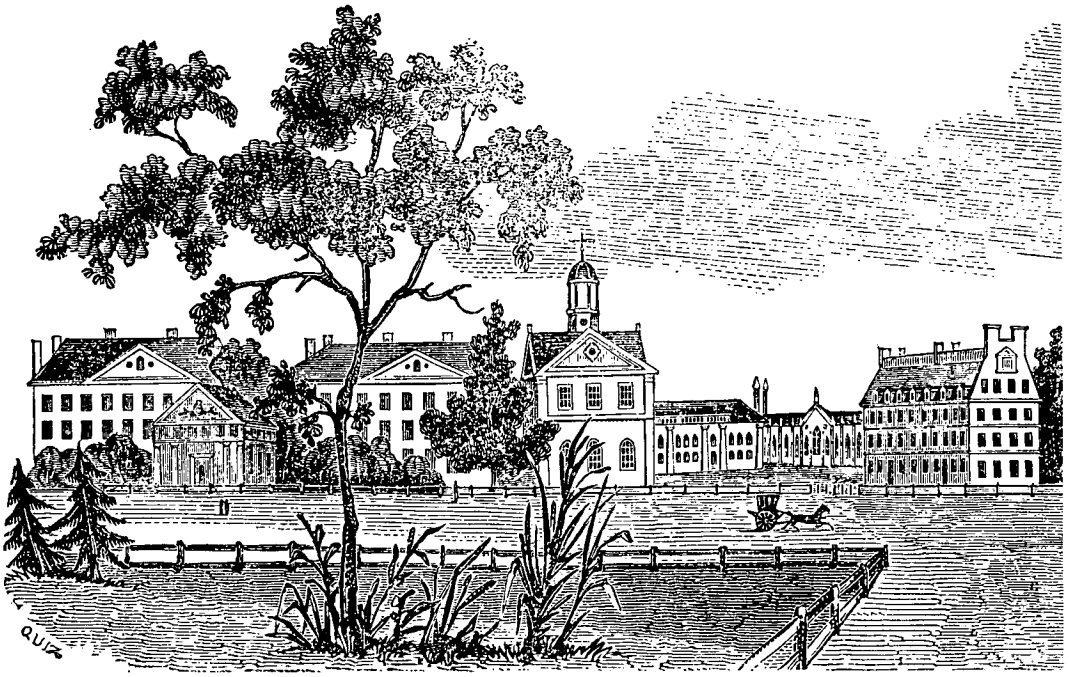

Harvard Hall (left center; built 1776), Harvard University, Cambridge, Mass., c. 1849.

that he got his drive shaft installed before his steering wheel."

It is a prime function of a liberal education to provide us with the moral equivalent of a steering wheel, and perhaps a map, as well. A bishop of the early church said much the same thing when he declared that society needs three kinds of men: those who work, those who fight, and those who pray. Society needs someone to grow the wheat and bake the bread. It needs someone to stand guard and protect the producer against marauders. But in addition, every society needs those who continually remind the rest of us that there is more to life than taking care of our creaturely needs. Man has a spiritual and intellectual nature with needs just as real as our physical hungers. Human life has meanings which transcend material comfort or even physical survival, and we will not resolve our material and social problems until we absorb those meanings and live by them.

Scholarship, therefore, has a significance beyond mere scholarship. The tradition of Western learning goes back to Socrates—or to Plato. These men laid down the lines along which most serious thought has moved until our own time. This body of thought, which goes back nearly two and a half millennia, comprises "the grand old fortifying classical curriculum" of our ancestors. It is like the Gulf Stream, coursing through the Atlantic as it comes down to us through the generations, touching, at any given time, only a handful of persons. There is only a little exaggeration in Emerson's observation that "There are not in the world at any one time more than a dozen persons who read and understand Plato—never enough to pay for an edition of his works; yet to every generation these [works] come duly down for the sake of these few persons. . . ."

The custodian of this intellectual treasure of ancient learning is the university. Every college in the American colonies consciously partook of this heritage, and likewise most of the colleges founded during the nineteenth century. The first of our colleges, Harvard, was founded in 1636. John Harvard, an eminent English divine, came to the new world in 1637 and was immediately involved in supporting the college. He donated half his estate, nearly 800

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pounds, plus his 320-book library, and a grateful citizenry named the college after him. William Bradford, of *Plymouth Plantation* fame, traces Harvard's line of descent: "A light was kindled in Newtown [that is, Cambridge] in the Bay Colony in 1636. But the spark that touched it off came from a lamp of learning first lighted by the ancient Greeks, tended by the Church through the Dark Ages, blown white and high in the medieval universities, and handed down to us in direct line through Paris, Oxford and Cambridge." Harvard College was largely a duplicate of Emmanuel College, the most Puritan of the Cambridge (England) colleges, and the one where John Harvard earned his Master of Arts degree. The Harvard curriculum was the classical liberal arts educational scheme unique to Western Civilization.

Western Civilization

A hundred and thirty years ago, Cardinal Newman paid an eloquent tribute to Western Civilization, the historic culture within which most of us were reared. Its nature is such, he argues, that, to all intents and purposes, Western Civilization and Civilization are equivalent terms. This idea is under deadly attack these days, so let me allow Cardinal Newman to say what he has in mind, in his own words: ". . . though there are other civilizations in the world, as there are other societies, yet this civilization, together with the society which is its creation and its home, is so distinctive and luminous in its character, so imperial in its extent, so imposing in its duration, and so utterly without rival upon the face of the earth, that the association may fitly assume to itself the title of 'human society,' and its civilization the abstract term 'civilization.' "

These words of Cardinal Newman are taken from a lecture he gave in Dublin in 1858. England was at the height of her powers, prestige, and self-confidence. Britannia ruled the waves; her colonies were on every continent, leading to the proud declaration that the sun never sets on the British flag. The English gentleman was regarded the world over as the model, as the human male *par excellence*. English was a universal language. "Never since the heroic days of Greece has the world had such a sweet, just, boyish master," declared the noted philosopher, George Santayana.

Much has happened since Newman's day to change that picture. We now know that high levels of civilization were attained in Asia and Africa thousands of years ago, long before Greece and Rome emerged onto the world scene. Civilization can no longer be regarded as simply a European thing. But note that it was through the work of European scholars during the past couple of centuries that the world came to know something of the glories of ancient China, India, and Egypt. The people of India had lost contact with their remote past, and owe it to the work of English scholars that ancient Hindu literature—such as the *Vedas* and the *Upanishads*—was discovered, translated from the Sanskrit, and read for the first time—in English—by Hindu students!

The growing awareness of ancient civilizations upset the idea that the culture whose time span stretched from Homer to the Victorian Age was the world's only civilization, and this new knowledge also caused Europeans to have a keener perception of the defects of their Western world. Besides, the English were weary of bearing the white man's burden, and, in the colonies, the natives were restless. Herbert Spencer, writing a letter to Grant Allen just before the turn of the century, voiced the opinion that ". . . we are in course of re-barbarization."

But it was World War I that really stunned the West and proved to the rest of mankind that Western world hegemony was but a shadow and no longer a thing of substance. The statesmen of Western nations played their dangerous games during the early years of this century, completely lacking in the kind of foresight which wiser statesmen might have employed to anticipate the horrible end results of the trends they had set in motion. A Serbian terrorist assassinated an Archduke and the whole house of cards began to crumble. A man named Francis Neilson resigned from Parliament in 1914 to publish his book, *How Diplomats Make War,* a piece of foresight that reads like hindsight. But not even Neilson could anticipate that the war would continue its slaughter for four dreadful years. Virtually no one in August of 1914 believed that the war

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would involve millions of combatants from nations all over the globe. Some did, of course. Viscount Grey of Fallodon, the English Foreign Secretary until 1916, uttered the gloomy prophecy, "The lights are going out all over Europe, and we shall not see them come on again in our lifetime." The opinion of the man in the street I heard from the lips of Max Brauer, the mayor of Hamburg in 1938, who lectured that year in Berkeley: "We all thought we'd be home for Christmas," that is, in four months.

A youngish German high school teacher spent the last year or so of the war writing a book. Volume I appeared in 1918; volume II in 1922. New York publisher Alfred Knopf brought out an English translation in 1926, entitled *The Decline of the West*. It was not easy reading and the thesis was dubious. But the pessimism of Oswald Spengler matched the post-war despair and gloom of many people in Europe and America, with the result that *The Decline of the West* was probably the most talked-about book and the most written-about book of the 1920s and '30s. Spengler's overwrought book seemed to say in exhausting detail what many felt in their bones—that Western Civilization was finished, *kaput*. Spengler despised the Nazis and had no use for Communism, but his devaluation of the West added fuel to Soviet expansionism by making it appear that some kind of Marxism was the only viable alternative now that the West was sinking below the horizon.

Our Present Situation

Where do we stand today? I think we must admit that Cardinal Newman's panegyric to Western Civilization was overstated; there were and are, we now know, other civilizations which merit our respect. That's the first point; and the second is to emphasize that although Western Civilization is not the only civilization, it is *our* civilization; and only persons firmly rooted in their native habitat can come to a proper appreciation of, say, Hindu culture, or Chinese culture. Those who are alienated from their native soil fall prey to charlatans. We have recently witnessed the spectacle of a grubby turbaned clown, who'd be ridiculed by real Hindu scholars, conning gullible Americans into parting with their money and with whatever wits they possessed in order to grovel at his feet. Genuine Hinduism serves the spiritual needs of millions of Indians, but fake Hinduism is a bad joke; and so, of course, is fake Christianity as other recent events remind us.

In any event—to return to our original theme—the liberal arts curriculum has been *the* educational scheme of Western Civilization, and will be again. A civilization like ours has immense and still untapped powers of recovery and regeneration—as its story is told in several of the books in my bibliography. It has been said that no civilization has ever been murdered, never destroyed from without. Civilizations suffer decay from within, and crumble; that is to say, they commit suicide. But a civilization which responds vigorously to challenges from within and challenges from without may renew itself. It all depends on the kind of people who compose that civilization. In other words, the fate of our society depends on us, and we can work on ourselves.

Reviving the Freedom Philosophy

It was a set of ideas along these lines that inspired Leonard Read to set up The Foundation for Economic Education 42 years ago. The American nation had lapsed into a New Deal type of socialism because this country's citizens, for several generations, had failed to educate themselves in the freedom philosophy. The beliefs upon which our eighteenth-century ancestors had erected the basic political and economic structures of this society no longer inspired us even to maintain those structures. And during the decades when the freedom philosophy was in remission, the ideologues of socialism carried on an unremitting campaign to persuade people that the government could run things better than we could run them ourselves. The socialists manufactured a new public opinion different from the original and, as a result of the inculcation of bad ideas, we are saddled with numerous bureaucratic interventions into every sector of our lives.

The suggested FEE remedy is two-fold: first, try to arouse an interest in personal liberty and the free society; and second, nourish this new

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interest in freedom by having on hand books, pamphlets, periodicals, and speeches expounding the freedom philosophy. Thus, gradually, bad ideas will be replaced by better ideas. Right action will follow. The Foundation emphasis is on self-education. And when you come right down to it, self-education is the only kind of education there is. A wise and experienced teacher is one who has been over the route before, so he can tell you where the minefields are, which roads are blind alleys and which are dead ends, and which books are worth studying. But there's one thing no teacher can do: he cannot educate you. You have to educate yourself. "Educate" is not a transitive verb, that is, education is not something that anyone can do to another or for another. But anyone who has the incentive can do it for himself.

I first encountered this approach years ago in a pamphlet by the eminent British novelist, Arnold Bennett; it was entitled "How to Live on Twenty Four Hours a Day." You can make your own life more exciting and fulfilling, wrote Bennett in the breezy manner of a novelist, if you resolve to learn some subject, any topic of your own choosing—like political economy—and make a pact with yourself to spend 90 minutes three evenings a week in intense study. This does not mean merely sitting down with a book in front of you, which is all you'll be able to do at first. You'll start to read, and after a few pages your mind will be miles away. Grab your mind and drag it back by the scruff of the neck! says Bennett, and gradually your mind will realize that you are in charge and that you mean business. At this point your mind will start to pay attention and do what you demand of it.

Another way to teach your mind that you are in charge of it is to spend a few minutes before retiring rehearsing the events of the day, hour by hour: what you saw, heard and did, whom you met, what you said, and so on. Once your mind realizes that it will be called upon to recite at the day's end, it will begin to pay attention during the day; you'll experience things more vividly and thus recall them more readily. Plan to keep a daily journal, as Leonard Read did for years.

The liberating arts require a lot of reading, and reading requires seeing, which is why I recommend *The Art of Seeing* by Aldous Huxley. Reading does not come naturally; reading is an acquired skill, like playing the fiddle or walking on your hands.

You can teach yourself to read better with books like Walter B. Pitkin's *The Art of Rapid Reading*. Several courses are now available which teach speed reading, but I don't know how well they live up to their claims. I do know it to be a fact that anyone can train himself to read easier, faster, and with greater pleasure. Better comprehension follows. Use a red pencil to bracket and underline salient points. This is an aid to memory and helpful for later review.

The Art of Thinking

Now that you have awakened a few billion brain cells and pumped some information into them, your mind will begin to churn out ideas and you'll be thinking lots of new and exciting thoughts. What is it like to think? Let me quote a few lines from Jacques Barzun, a first-rate thinker: "Thinking is inwardly a haphazard, fitful, incoherent activity. If you could peer in and see thinking going on, it would not look like that trimmed and barbered result, A Thought. Thinking is messy, repetitious, silly, obtuse, subject to explosions that shatter the crucible and leave darkness behind. Then comes another flash, a new path is seen, trod, lost, broken off, and blazed anew. It leaves the thinker dizzy as well as doubtful; he does not know what he thinks until he has thought it, or better, until he has written and riddled it with a persistence akin to obsession."

Once you get hooked on thinking you'll be irresistibly drawn into writing, and you'll quickly discover that almost no author who relies on the contents of his own mind alone ever wrote a readable essay, let alone a book. Every thinker and writer needs to know how to use reference books and conduct research, and the complete guide to this is the book, *The Modern Researcher*, by Jacques Barzun and Henry Graff. But you cannot stop there; you have to learn to write passable English prose, and there's no easy way to do that. The most helpful book on writing, in my view, is

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Barzun's *Simple and Direct*. If you're interested in knowing how the ancient Greeks went about the chore of putting together a persuasive speech, look into Aristotle's *Rhetoric*.

The human person is emphatically *not* the mere accidental end result of the chance interaction of physical and chemical forces, however much it might please certain of our contemporaries to believe this. Nor is man some untidy excrescence appearing on the earth's surface sometime between the last two ice ages, tossed about by the same natural forces which rust iron and ripen corn. To the contrary, every man and woman is a work of divine art; through our being flow the primordial creative forces of the universe. Coordinate with those forces and we become creators too, some of us in small and others in large measure.

Novelty comes onto the cosmic scene with every thought we think. The future is still in the making, and there's no action we take that does not alter the future in some degree. The future really *is* in our hands, and this is a responsibility we cannot avoid. Even if we do *nothing*, the future inexorably records our inaction, by being a little bit different than it would have been, had we done *something*.

The center of human creativity is the individual human mind, and the creative process in thought, literature, music, and art is the subject of *The Creative Process*, a wide-ranging anthology edited by Brewster Ghiselin.

To sum up: I've had some things to say about the ages-old liberal arts curriculum as an essential element of Western Civilization. Now that we know something of other great world civilizations we realize that we can learn from them, but only if we retain a firm hold on our own heritage. I have pointed out that education is not at all the same thing as schooling, and I have argued that education and training are not quite the same. All genuine education is self-education. But you must first train yourself, in order to acquire the tools of learning you need to educate yourself with. Education deals with ideas, and ideas rule the human world. The man or woman who thinks is an influence on those who come into contact with him, and by his thoughtful actions he exerts leverage over the future.

Albert Jay Nock was a product of "the grand, old, fortifying classical curriculum," and it's fairly safe to refer to Nock as the most exquisitely educated gentleman of the first third of this century. And Nock thought of himself as a superfluous man! It is certainly true that a classical education will not make you the life of the party; it won't put you among the rich and famous; it might even make you feel superfluous. But "the fun is in the going"; where it gets you is secondary. Self-education is a never-ending series of challenges. Each challenge we surmount only confronts us with a bigger and more complex challenge—and a wider horizon. But that's what life is all about. And such a life is never dull! □

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The Decline of Secondhand Bookstores

by Herbert London

Jacques Maritain once said that what distinguished New York from the other great cities of the world is that it is in constant flux. New York does not treasure its past as is the case in Paris; it treasures the future. There is much in the recent history of this city that supports that claim.

Nevertheless, there are New Yorkers who continually lament the loss of the past. One of the most vocal groups is comprised of bookstore owners and shoppers on Bookstore Row (the area on Fourth Avenue between Ninth and Fourteenth Streets). According to these people the used bookstore is gone forever, a casualty of bottom-line economics. The culprit in this scenario is rising rentals and, as one might guess, the proffered solutions are government subsidies, the use of government-owned space, and commercial rent control.

However, the analysis of the problem as well as the much-discussed answers leave much to be desired. The actual decline in used bookstores did indeed occur for economic reasons. But these reasons are related to the value or lack thereof in used books far more than to the obvious rises in rent. The fact is paperback books and discounted hardbacks have virtually eliminated a general interest in used books. It's hard to be in the business of selling a commodity that has limited or nonexistent value.

Yet antiquarian bookselling manages to survive and in some places thrive. The Gotham Book Mart, the Strand Book Store, the Pageant Book and Print Shop and the Academy Book Store are examples of stores that are prospering. Fred Bass, the owner of the Strand Book Store, the nation's largest used bookstore, said, "My rent tripled . . . but I think it's a healthy business." The reason why these stores prosper is that they provide a service to their clients that cannot be offered in the bookstore chain outlets.

As is often the case when economic conditions change, businessmen adapt. Many of those stores that were fixtures on Fourth Avenue have been converted into off-street mail-order and catalogue sales outfits serving an established clientele. Several of the used book dealers have convertible fold-away street stands that can be taken to the parks or a book fair. Surely the glory days of row after row of used bookstores below Union Square is gone or going. But it would be an error to conclude that used bookselling is on its way to extinction.

Efforts to stop or curtail economic trends—in this case through rent subsidy or rent control—are doomed to failure, as are virtually all efforts to impose the will of a command economy on markets. The tale of used bookstores in New York is, in a sense, the story of this city. What is fashionable changes. What is affordable changes as well. The low rent district of today may be the high rent district of tomorrow. Were it not this way, New York would be a static town.

Interest groups like bookstore owners, community boards, and the rent control lobby would like to see a city in which their concerns are protected through government intervention. To an extraordinary degree these groups have flexed their political muscle and found responsive city politicians. But that is no way to run a city, especially a city as dynamic as New York City. Markets may not be the perfect adjudicator of competing interests, but they are far more efficient over the long term than the "visible foot" of government interference. The disappearance of Bookstore Row and the survival of used bookstores would seem to prove this point. □

Dr. London is Dean of the Gallatin Division at New York University. This article is excerpted from the April 1988 issue of his monthly newsletter, The London Letter.

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Origins of the German "Economic Miracle"

by Robert A. Peterson

This year marks the 40th anniversary of Ludwig Erhard's sweeping free market reforms which gave economic freedom to over 80 million Germans and began West Germany's 30-year post-war economic miracle.

At the end of World War II, Germany was in a shambles. Fire bombs—more destructive than the atomic bombs that were dropped on Hiroshima and Nagasaki—had completely destroyed Dresden. The population of Cologne had dropped from 750,000 before the war to less than 32,000. Germany's storybook castles and great cathedrals lay in ruins, while makeshift shanty towns housed hundreds of thousands of Germans displaced by the Soviet occupation of the Eastern Provinces.

Industrial output was at a standstill, and German currency was practically worthless. A pack of American-made cigarettes could fetch more goods on the black market than hundreds of German marks.

William H. Peterson, who was a member of the Allied occupation forces, described the scene this way: "German men and women, for the most part ragged, hollow-eyed, thin, forlorn-looking, peddled what wealth had escaped the bombing and burning—silver, jewelry, Zeiss binoculars, Leica cameras, Meissen china (frequently chipped) and bric-a-brac including ashtrays, lamps, clocks, and cheap paintings—all at fancy prices. I saw a used commonplace alarm clock go for the equivalent of $85—in 1945 dollars."[1]

Mr. Peterson is headmaster of The Pilgrim Academy in Egg Harbor City, New Jersey. His articles have appeared in a variety of publications, including National Review *and* Human Events.

There was little hope for improvement. Incredibly, the Allies—who had freed Germany from the Nazi terror—imposed their own form of economic tyranny by maintaining Hitler's price and wage controls.

Enter Ludwig Erhard. Born in 1897 in Furth, and educated at the University of Frankfurt, Erhard had been a disciple of the great free market economist, Wilhelm Roepke. After serving as an economist in Nuremberg, Erhard was appointed head of the post-war Bizonal Economic Council. Looking over the wreckage from six years of total war, Erhard knew that only free market policies could get Germany back on its feet. To that end, he made two proposals: introduce a new currency, then insure its success by lifting wage and price controls.

None of the experts doubted the necessity of his first proposal, but lifting wage and price controls? That went against current orthodoxy. When General Clay, military governor of the American Zone, informed Erhard that all the American economic experts were gravely concerned about the consequences of scrapping the wage and price controls, Erhard replied, "So are mine."[2]

Yet Erhard plowed ahead. He knew his history: more than 2,000 years of price and wage controls had always resulted in economic chaos. Not only do price and wage controls destroy incentives, Erhard pointed out, but they almost always transfer wealth from hard-working, patriotic citizens into the hands of cynics, bureaucrats, and those favored by the government.

Taking the country by surprise, Erhard went on the air on a Sunday night in June 1948.

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First, he announced that each German would be given forty Deutschmarks (replacing the old Reichsmarks). This would be followed by a second installment of twenty Deutschmarks. Credits and debts would be converted into the new currency at the rate of ten to one, and people would have to prove how they came by sums that exceeded 5,000 Reichsmarks.

Erhard knew that his current reform would be doomed if the new money, like its predecessor, faced bare store shelves and empty warehouses. To prevent this, Erhard announced the second—and by far more important—part of his program: most of Germany's wage and price controls would be dropped. First, controls would end on a wide range of consumer goods. Within six months, controls on food would be dropped. Erhard gained support for his measures by billing them as a patriotic move designed to replace a "foreign" economic system that had been imposed on Germany. The German people were astonished to hear that all these changes would commence the next morning.[3]

Almost immediately, the German economy sprang to life. The unemployed went back to work, food reappeared on store shelves, and the legendary productivity of the German people was unleashed. Within two years, industrial output tripled. By the early 1960s, Germany was the third greatest economic power in the world. And all of this occurred while West Germany was assimilating hundreds of thousands of East German refugees.

The Marshall Plan certainly helped, but its influence was not great enough to cause the German "miracle." As historian LaVerne Ripley points out, "vastly larger sums have been donated to other countries without preventing their economic disaster."[4]

Since the 1960s, Germany has turned away from Erhard's free market policies. Many German young people missed the significance of Erhard's reforms, while as *U.S. News & World Report* recently observed, "Chancellor Helmut Kohl has been a timid free-marketer."[5] After achieving wealth and leisure time by pursuing free market policies, a new generation of social engineers has devised schemes to divide the wealth, disregarding how that wealth was created. Intellectuals provided moral support for the move toward socialism, even though the very leisure they used as an excuse to undermine capitalism was itself the result of capitalism. The process is still going on.

The move toward socialism has manifested itself in higher taxes (West Germany has the highest corporate taxes of any Big Five economic power), unreasonable demands from labor unions, a 37.5-hour work week, and over-regulation. The result is that West Germany is, as one commentator put it, "Rusting on the Rhine."[6]

German legend has it that the great medieval ruler, Frederick Barbarossa (Red-Beard), is asleep inside Kyffhauser Mountain in Thuringia, awaiting the day when Germany is about to be destroyed by its enemies. Just at the last moment, so the legend goes, Barbarossa will be awakened by ravens encircling his mountain top. He will then arise and wrench his homeland from defeat and bear her to the glory of a new golden age. (There was method in Hitler's madness when he code-named his invasion of Russia "Operation Barbarossa.")

Ludwig Erhard didn't sport a red beard, nor is there any evidence that he spent much time near Kyffhauser Mountain. But he did save Germany, for a time, from one of its greatest enemies—socialism—and helped bring about one of the great success stories of the modern world. Today, West Germany, as well as the rest of the world, would do well to learn from Ludwig Erhard's example, on this, the 40th anniversary of his reforms. □

1. William H. Peterson, "Inflation: Soviet Style, 1945," *The Freeman*, April 1985, p. 208.
2. William Henry Chamberlin, "The Failing Dynamo," *The Freeman*, May 1969, p. 293.
3. "Forty Years old, Deutschmark is Still Going Strong," *Der Deutsch-Amerikaner*, June 1988; Robert-Herman Tenbrock, *A History of Germany* (Munchen: Max Heuber Verlag, 1968), p. 315.
4. LaVerne Ripley, *Of German Ways* (New York: Barnes and Noble Books, 1970, 1980), p. 227.
5. Pamela Sherrid, "Rusting on the Rhine," *U.S. News & World Report*, April 11, 1988, p. 36.
6. *Ibid.*

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Profits from Power: The Soviet Economy as a Mercantilist State

by Gary M. Anderson

Austrian economics has achieved at least one clear and unambiguous victory in the battle of ideas in this century—the Austrian critique of the possibility of socialist calculation handily won the debate in the 1930s and 1940s (see Karen Vaughn's 1980 article for a recent assessment of this intellectual triumph). Mises' classic 1920 statement, later supplemented and expanded by F. A. Hayek (1948), Lionel Robbins (1934), and Ludwig von Mises himself (1949, and elsewhere), argued that rational economic calculation under socialism is impossible. Rational allocation of scarce resources requires market exchange in the context of money prices; socialist planners cannot hope to replace the price system with a central planning organization while retaining coordination in the complex structure of production of a modern economy. Mises stated his critique unequivocally:

> Without calculation, economic activity is impossible. Since under Socialism economic calculation is impossible, under Socialism there can be no economic activity in our sense of the word. In small and insignificant things rational action might still persist. But, for the most part, it would no longer be possible to speak of rational production. In the absence of criteria of rationality, production could not be consciously economical. (1936, p. 119)

But while there remains little doubt that the Austrians vanquished their socialist opponents on the battlefield of ideas, the fruits of that victory have been few, for a simple reason. Orthodox comparative systems economists have long rejected the Misesian critique as clever but ultimately irrelevant, because it seemed obviously refuted by a historical counter-example—the real-world experience of the Soviet Union, not to mention China, Cuba, and numerous other Soviet-style economies, which, despite major endemic inefficiencies, appear to generate high levels of complex output by way of comprehensive central planning. In other words, the Austrians won the battle but lost the war because "socialist economies" *must* be possible (regardless of the Austrian critique), demonstrated by the fact that they actually exist.

The intention of the present article is to suggest an alternative analysis, one which is more consistent with the straightforward and uncompromising critique of socialist planning originally propounded by Mises. We will argue that the Soviet Union—and by extension, Soviet-style economies elsewhere—are not examples of *socialism* but rather modern examples of *mercantilism*. Such economies are "rent-seeking societies," in which the government controls, described as "central planning," in reality provide monopoly profits for a privileged minority at the expense of consumers in general. The ideological claims made by the beneficiaries of such policies may play a significant role in maintaining the stability of the system, but do not necessarily reflect the actual economic motivations of those beneficiaries. In short, Mises *was* right, whereas the usual ac-

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count of the "facts" involving the Soviet economy is confused and misleading.

Is the Soviet System a Planned Economy?

In *The State and Revolution* (1917), Lenin wrote:

> The whole of society will have become a single office and a single factory with equality of work and equality of pay. . . . we have a right to say with the fullest confidence that the expropriation of the capitalists will inevitably result in an enormous development of the productive forces of human society. (quoted in Polanyi, 1940, p. 27)

Lenin's conception of the Soviet-style economy as "one big factory" is generally shared by Western economists and Sovietologists. The Soviet economy is frequently referred to as the "U.S.S.R., Inc." Robert Campbell, a leading economic analyst of comparative systems, describes the Soviet-style socialist economy as " a kind of supercorporation charged with running the economy under unified management and for a centrally determined purpose."

The conventional analysis of the functioning of the Soviet economy can be briefly summarized. In the Soviet economy, official prices are not determined by the free play of market forces, but by bureaucratic fiat, and tend to be very inflexible over time. According to the Soviet government, prices are merely a bureaucratic accounting tool in an economy based on comprehensive "quantity adjustment" rather than the price adjustment typical in market economies. Most Western analysts take this assertion at face value. Furthermore, the "U.S.S.R., Inc." is supposedly insulated from the competitive constraints characteristic of market economies. Input suppliers are *assigned* to producers, and the planning board, not the consumer, is sovereign. As Svetozar Pejovich describes the system:

> The Soviet government allocates resources and assigns productive targets to all industries and firms in the economy. All decisions concerning the level and character of the economy flow from the top leadership through various bureaucratic channels down to productive units. The sum total of these administrative orders is the economic plan. The plan is a law of the land; and individuals who are caught interfering with the plan might be taken to court. (1976, p. 98)

The planning process supposedly works in the following manner. The party leadership sets objectives for the economy (specific levels of military output, consumer goods, etc.). The central planning agency (Gosplan) creates an economic plan designed to achieve these objectives for a five-year period, and assigns plan targets to industries and firms. One of the most pressing problems the planners face is the need to establish "material balances"—i.e., demonstrate that the plan's targets are consistent with existing productive capacity and resources. Balances are drawn up for all products; the balance for each input shows its sources and uses. Allocation of inputs to individual enterprises is determined on the basis of material balances and production targets (see *ibid.*, pp. 99-100, for a good summary of this argument).

This is what the Soviet regime says the planning agencies are doing, but there are reasons to doubt that the planning process actually works this way. In fact, there is a recurring debate in the comparative systems literature about whether the Soviet economy is "really" centrally planned. There is considerable evidence that much, if not most, of the supposedly "planned" sector is not *planned* at all, or at most "planned" after the fact. For example, Alec Nove (1977, p. 110), writes: "[in] practice, enterprises order material and equipment for next year in April-June of the current year, that is, 6-8 months before next year's plan becomes known." According to Birman (quoted in Wilhelm, 1980, p. 270): "[it] is correction of the plan during the process of its fulfillment that makes good the mistakes and miscalculations of the planners and averts many disagreeable consequences." The same author adds in a footnote: "[the] secret behind plan fulfillment by nearly all branches and republics of the annual plan for gross output is, in principle, that at the very end of the year the plan is changed to expected fulfillment." The annual plans are apparently amended quite frequently in order to

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"better fit the conditions of particular enterprises." According to a sample survey covering 95 enterprises in the Novosibirsk area reported by *Pravda* on November 12, 1973 (cited by Nove, 1977, p. 103), in an average year these enterprises received a total of 1554 amendments to the annual production plan. As Nove notes, "the non-stability of norms is notorious." Elsewhere, Nove explains:

> [the essential point] is that in most instances *the centre does not know* just what it is that needs doing, in disaggregated detail, while the management in its situation *cannot* know what it is that society needs unless the centre informs it. Despite all the talk about reform and direct links, the fact remains that in a basically non-market model the centre must discover what needs doing, and the centre cannot do this in micro-detail. (1977, p. 105; italics in original)

Problems of this sort have caused some comparative systems analysts to insist that the Soviet "centrally planned economy" is not *literally* centrally planned in a complete sense, but rather that the central planning authorities set a broad agenda for economic production which permits much initiative on the part of management of actual productive units. Thus, Nove (1975, p. 136) argues that while the "centrally planned" economy may not be literally planned in detail from the center, the term is still useful, just as the term "absolute monarchy" is useful and descriptive in reference to the ancien régime, however literally inaccurate. In other words, the term "central planning" is most commonly used among experts on the Soviet economy as basically a figure of speech.[1]

This is clear in discussions of the so-called "ratchet principle." Briefly stated, this means that the plan issued to any given enterprise from Gosplan (the central planning board) via the relevant ministry will instruct the enterprise to produce at least as much of whatever it produces as it produced last period. The past year's output becomes a baseline for determining next year's planned output. There is extensive discussion in the comparative systems literature about the problems associated with this method (e.g., perverse incentives confronting managers; see Berliner 1976, pp. 65-67, and Pejovich 1976, pp. 99-102). A more fundamental point is usually neglected. A method of "planning" which is based on simply directing enterprise managers to maintain output at previous levels is equivalent to planning after the fact, and bears little relationship to the stylized models of central planning offered in many comparative systems textbooks.

So, we are left in a quandary. Mises and Hayek demonstrated that a centrally planned economic system is impossible. Furthermore, the conventional wisdom among students of the modern Soviet economy is that comprehensive central planning—the point at issue in the socialist calculation debate—is not practiced in the Soviet Union (and, by implication, in the numerous nations which have adopted the "Soviet model" in whole or in part). Yet the Soviet economy is alive (if not well), and the Soviet economic model is widespread and popular among dictatorships throughout the world. The remainder of the present article will attempt to articulate an alternative theory of the "socialist" economy which is both consistent with the known facts *and* with the Misesian critique of the impossibility of central planning.

The Soviet Economy as a Mercantilist System

As we have seen, the Soviet economy is clearly not centrally planned in the strict sense. Even among Western experts in comparative economic systems, the notion of "planning" applied to the Soviet economy is extremely murky. The consensus judgment seems to be that the Soviet economy is characterized by a very high level of government intervention, but that at best only a relatively small portion of the overall economy is centrally planned in any detail. It is unclear how this situation can be economically distinguished from a case where the government in a country with a market economy controls a large "nationalized" sector.

Also, scholars of the Soviet economy widely recognize that "central planning" is, practically speaking, observed mostly in the breach. Nevertheless, it is commonly asserted that virtually the entire Soviet economy is centrally

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planned (e.g., see Kaiser, 1984, p. 344). Presumably, this means that central planning—whatever it is in practice—is technically applied to the entire economy. But in fact, there is a substantial private sector in the Soviet economy. This is a segment of the economy which is not, even in the loosest sense of the term, "planned." The comparative systems literature often mentions the importance of private agriculture (on small, privately owned agricultural plots) in overall agricultural output. However, this is only the tip of the iceberg. The "parallel" or "second" economy, comprising economic activities which are illegal or quasi-legal, may be very large. Various estimates of its size range from 10 per cent to 40 per cent of GNP. This is in addition to the legal private economy (e.g., private farm plots) which probably contributes between 10 and 20 per cent of GNP. A recent RAND Corporation report prepared for the Department of Defense, which probably understates the level of activity in the "second economy," estimates that, on average, 11.5 per cent of total household income in the U.S.S.R. came from private sources. This study also estimates the average share of family expenditures made in the "second economy" to be 18 per cent. One scholar estimates the share of the "second economy" throughout the U.S.S.R. as 25 per cent for alcohol distillation, 80 per cent for fur production, 61 per cent for domestically consumed fish, and (in Moscow) 70 per cent for home repairs and decorations (see O'Hearn, p. 226). The second economy is relatively more important in certain areas of the Soviet Union. For example, in Kazakhstan, an estimated 80 per cent of petrol and lubricants was supplied outside of "official" channels; in Georgia, at least 98 per cent of house repairs and 97 per cent of appliance repairs are supplied by the second economy.

But in an important sense, it would be false to claim that this "private sector" can be sharply distinguished from the "planned sector." Much of "second economy" activity is based on evasion of legal entry restrictions.

Legal monopolies in the form of entry restrictions are pervasive in the Soviet economy. According to Berliner (1957, p. 408): "The central planning system, with its ministerial organizational structure drawn on industry lines, has tended to erect barriers against invasion. If the same barriers prevail . . . the possibility of invasion would continue to be remote. Producers would be expected to restrict their horizons and not poach on the markets of others."

Nove (1977, p. 116) elaborates further: "A key factor [in the Soviet economy] . . . is the sellers' market plus monopoly. In an economy of shortage, the supplier is powerful. He can insist on his own terms . . . [the] monopoly element is provided not merely by the fact that the state owns all of industry, since without state ownership one would still have a competitive situation, but particularly because the customer . . . is not allowed to go elsewhere."

Legal Controls on Price Competition

The most important restrictions are the legal controls on price competition. This is generally considered the hallmark of a socialist economy: market economies may have very large public sectors, but can only become socialist when they abolish the free market price system.

Of course, according to the conventional wisdom, the central planning authorities use a sort of price system, but one in which all prices are set by the planners. Prices are strictly an accounting tool, and are not designed to reflect relative scarcity of resources. Some economists have described the Soviet economy as not monetary but "documonetary," in which money serves an accounting function, but cannot actually command resources—documents issued by the central planning authorities are necessary to do so. According to Berliner (1976, pp. 88-89), the producer is forbidden by law from selling a commodity to a purchaser who does not possess an allocation certificate; allocation certificates are issued by the supply planning agencies and are needed for most important purchases.

However, in the Soviet-style economy (as in Western economies during periodic episodes of governmental price control) *official* prices do not necessarily correspond to *effective* prices in actual exchange. As was the case in the United States during World War II and in other historical examples of governmental price controls,

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effective prices (i.e., "black market prices") appear to be flexible, despite the fixity of official prices.

In economics, monopoly is analytically significant only in those cases where there are associated monopoly rents (profits accruing from a monopoly). But while many comparative systems analysts recognize the existence of extensive monopolistic restrictions in the Soviet economy, they overwhelmingly eschew the next logical step in the analysis: what happens to the monopoly profits we expect to find associated with such restrictions on competition?

The simple answer appears to be that monopoly profits flow to those officials in the fortunate position to transfer resources from consumers to themselves. Simis (1977, p. 149) reports that the deputy director of the supervisory board of the Ministry for the Automobile Industry and his close associates countersigned requisition notes for the supply of vehicle parts at a rate of 1,000 rubles per requisition (i.e., about three months' official pay for the average Soviet worker); moreover, their regular clients rented a flat in Moscow for the Ministry officials to hold parties and orgies in. In another incident, the deputy director and chief engineer of a construction trust supplying state farms with building materials received between 20,000 and 40,000 rubles from each farm the trust had dealings with, in order to expedite deliveries. In another case, an official in the Novolipetsk Metallurgical Combine took large bribes for many years (which included such items as cases of champagne and a complete kitchen range) for releasing supplies of metal against dispatch notes.

In 1964, a KGB investigation revealed that the entire leadership of the government and Communist Party in Kirghizia, headed by the First Secretary of its Central Committee and the Chairman of its Council of Ministers, had been in the pay of a gang of underworld racketeers for a number of years. The latter allegedly had set up an extensive network of dozens of clandestine factories, collective farms, and plantations of opium and cannabis, the income from the sale of which was split with the officials. Interestingly, in this case only the underworld gang and one junior deputy minister were eventually brought to trial (*ibid.*, p. 146).

Voslensky (1984, p. 191) reports that in the early seventies, the President of the Supreme Soviet of the Soviet Republic of Azerbaijan sold pardons to convicted felons, and charged 100,000 rubles in cases involving long imprisonment. In the same period, the Azerbaijani Communist Party allegedly sold appointments to various positions in government for large sums: 30,000 rubles for District Public Prosecutor, 50,000 for Chief of the District Militia, 80,000 for manager of a Sovkhoz collective farm, and 200,000 for appointment as First Secretary of the Party District Committee.[2]

Paying the "Price" of Admission

According to Grossman (1977a, pp. 32-33), admission to academic institutions in the Soviet Union is often accomplished by way of bribery. The "price" of admission varies with the quality of the institution, and also varies across republics. The scale of bribes necessary to secure admission to the universities in Moscow and Leningrad varied between 1,000 and 3,000 rubles, but admission to the medical institute in Georgia cost 15,000, and in Azerbaijan, 30,000 rubles.

There seems to be no way of accurately estimating the magnitude and extent of such activity in the entire Soviet system. We recognize that these examples, and many others we could add, must in each individual case be treated cautiously, because they are derived from reports in the official Soviet press. Ostensibly such activities are illegal, and the official press publicizes such examples to deter potential wrong-doers. In reality, a number of observers have noted that high officials accused of corruption normally go unpunished. The individuals whose corruption becomes the subject of articles in *Pravda* may be only those who have somehow acquired enemies more powerful than themselves. By the same token, stories of corruption reported in the Soviet press may sometimes be entirely concocted by the KGB at the behest of Soviet rulers, and may only represent a glimpse into a secret power-struggle.[3] The examples are not intended as empirical evidence—which may be unobtainable even in principle for obvious reasons—but

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simply as illustrations of rent-seeking (the pursuit of monopoly profits) that we would predict is probably widespread.

A plethora of similar examples could easily be added.[4] Officials in command of particular entry barriers in the U.S.S.R. are in a position to obtain profits resulting from the exercise of coercive restrictions on competition in the form of bribes, which are sometimes of enormous size. In the Soviet system, entry into competition is technically prohibited, but can be achieved—but only by "paying off" the enforcers of the restrictions. The extensive and elaborate system of "fixed (official) prices" represents opportunities for profits from actual bribery, and also from artificially increased prices creating gains in the form of legal monopoly revenue increases to favored producers. The examples listed above involve monetary bribes, but bribes in the form of transfers of goods and services (and "favors") are probably more important and more widespread, because they are inherently more difficult to trace. Grossman (1977b, p. 841) argues that simple bribery is relatively uncommon, but regular tribute is normally paid to those in positions of bureaucratic power by those subject to that power, and that this in-kind tribute is easier to conceal.

The system of officially "fixed" prices offers numerous opportunities for blatant profiteering on the part of officials who are assigned to administer the economic controls. The officials in charge of issuing the necessary documents to command resources can potentially gain a significant increase in their income by marketing these documents to the highest bidder. An example of this kind of market evasion of price controls which has received a notable amount of attention in the Western press is the illicit marketing of above-minimal quality medical care to patients by doctors, in the context of ostensibly "free" hospital services.[5]

This system, dominated by the pursuit of monopoly profit on the part of privileged producers and officials (the beneficiaries of the extensive economic controls and regulations), bears little resemblance to the idealized vision of a centrally planned economy (which in any event Mises and Hayek proved to be impossible). Instead, it closely resembles a real-world economic system which has received much attention from historians: the mercantilist economy of France under Louis XIV. Under the mercantilist regime, most production of marketable output was extensively regulated by the central government, and regulations were enforced by paid civil servants called *intendants*. These regulations were overtly designed to enforce barriers against competitive entry, and the monarchy openly sold regulations as cartel enforcement services. According to Ekelund and Tollison (1981, p. 88), revenues from the sale of these regulatory entry barriers were the chief source of revenue to the monarchy.

Of course, the regime which imposed this detailed system of controls on the economy in France was the same regime that built the opulent palace of Versailles and maintained by far the largest standing army in Europe. Mercantilism in pre-revolutionary France was established on frankly venal grounds, and was not overlaid with any significant ideological facade. It was simply a means by which the monarch raised revenue.

Mercantilist France and the Modern Soviet Economy

Many scholars argue that this system of extensive and detailed mercantilist controls suffocated the incipient industrial revolution in France (see North and Thomas, 1973). Heckscher argues that the major difference between England and France that helps to explain why the Industrial Revolution took place much earlier in England was that England had a relatively weak and poorly enforced system of mercantile regulations, while those in France were very strong and robust. (Ekelund and Tollison, 1981, Chapters 3 and 4, make this argument in much more detail.)

There are a number of important differences between the system of mercantilist regulation in France and the modern Soviet-style economy. There was no central planning bureaucracy, or anything remotely resembling it, in seventeenth-century France. The Soviet Union employs an army of special troops to seal its borders to potential emigrants, whereas the government of France made no such effort.

The French monarch sold legal monopolies

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and many positions of regulatory power to the highest bidder. In the Soviet Union, positions of significant regulatory authority and control of legal monopolies ostensibly are assigned by the Communist Party on the basis of loyalty and merit. Managers of enterprises, officials in the Party and the central planning apparatus, as well as almost all other official positions—those which potentially provide access to significant income in the form of bribery and other forms of corruption—are selected from approved lists (*nomenklatura*) that are drawn up by the Communist Party and the KGB.

We know very little about the process by which the membership in the *nomenklatura* is determined. Voslensky (1984, p. 76) argues that loyalty to the Communist Party and political reliability are critical factors in the criteria for selection of candidates. It would be very surprising if the Soviet regime did not act to ensure that those in positions of economic power were not threats to the regime. Given the widespread benefits, pecuniary and non-pecuniary, associated with membership in the *nomenklatura* which several writers have detailed (ranging from permission to shop in stores carrying high quality goods to actual bribes, or *blat*), we would predict that potential members would bid competitively for such opportunities. Unfortunately, we have little recourse to informed speculation concerning this process. Non-pecuniary bribery is evidently a common route into the ranks of the *nomenklatura*, and there is some evidence that membership is increasingly becoming a de facto hereditary privilege, with parents insuring that their children also become members (*ibid.*, pp. 100-102).

In the case of mercantilist France, the "purchase price" of a monopoly restriction or official office would ultimately flow to the monarch; the *intendant*-enforcers were simply the paid agents of the autocrat. The situation is unlikely to be so simple in the U.S.S.R. It seems unlikely that a successful candidate for manager of a tractor factory sends an envelope full of cash to the General Secretary of the Communist Party.[6] There are reasons to believe that there may be several competing power centers in the Soviet state (the Soviet regime is sometimes described as a "troika" composed of the Communist Party, the KGB, and the military), which would make the system of Soviet "mercantilism" inherently much more complex than that of pre-revolutionary France. But the basic similarity remains.

The *nomenklatura* may play an important role in perpetuating the system in the face of massive economic inefficiency generated by the extensive restrictions on market exchange. The *nomenklatura* functions as a large, powerful, highly organized and cohesive interest group whose members benefit significantly from the present system, which they basically control. The Soviet consumers are greatly harmed, but face extremely high organization costs (e.g., the KGB). The often-reported continuing struggle of the KGB against "dissidents" can be interpreted as the (successful) efforts by the interest group composed of the *nomenklatura* to prevent the effective organization of consumer interests.

Two Types of "Second Economy" Activity

In this context, it is necessary to distinguish between two types of "second economy" activity. That which represents the exploitation of monopoly positions by the officially appointed holders, or franchisees, is the form in which monopoly profit (or rent) is extracted from consumers. For example, the monopolist shoe producer cannot raise the official price of shoes, but he can extract surpluses from consumers by requiring "extra" unofficial payments, or bribes, from them. The other major form of underground exchange involves the attempts by outsiders illegally to enter into competition with established monopolists, e.g., the private shoe producer who competes with the State shoe factory. This second category also would include cases of agent-principal problems, where the employees of State monopolists divert rents to themselves illicitly (e.g., a clerk at the Univermag department store who restricts the sale of high-quality items to "special" customers who pay him or her a bribe on the side). Both types of activity indicate the degree to which market exchange, without even the pretense of "planning," characterizes the Soviet economy in practice, even though only the first type is relevant to understanding the purpose of

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the system from the perspective of the Soviet leadership.

It is widely recognized (cf. Andrle, 1976, Conyngham, 1973, and Hough, 1969) that the Communist Party plays a very active role in the Soviet economic system. The Party maintains a large supervisionary apparatus which oversees the operation of enterprises, and is chiefly responsible for the selection of managers.[7] Andrle (1976, p. 102) explains that Party "industrial instructors" monitor closely, and actually participate in, enterprise decision-making.[8]

What has not been recognized is the high degree of similarity between this set of Party functions and the function of the *intendants* in the French mercantilist system around the time of Colbert. Any system of monopoly restrictions requires enforcement to prevent illicit competition from dissipating the monopoly rents and rendering the monopoly rights worthless. In mercantilist France, the *intendants* system was designed to accomplish just that. *Intendants* were detailed to monitor markets in local areas and sanction illicit competition (see Ekelund and Tollison, 1981, pp. 85-91).

Illicit competition may tend to take another form—official enterprises may begin to compete with one another, improving consumer welfare but at the same time lowering the profits which the state-sponsored cartels can earn in the long run. A system of *intendants* could help to solve this "problem" as well. A system of industrial inspectors ("snoopers") may help to prevent firms from undercutting the official cartels by offering lower priced goods, producing more or different goods than assigned by the relevant ministry, and in general behaving competitively.

In fact, this may be the basic function of the "central planning apparatus"—the army of bureaucrats and officials who purportedly administer the economy from the center in excruciating detail. The socialist calculation debate aside, as we saw previously, there is ample evidence that the central planning bureaucracy only "plans" after the fact anyway. However, this suggests an alternative possibility. The central planning bureaucracy may be simply an enormous system designed to coordinate the activities of numerous cartels of producers in the economy. As we have seen, much of the economy is organized by the state in the form of producer cartels, and the central administrators of the regime face a peculiar problem: how can the various different cartels be prevented from competing with one another? Even if competition can be effectively controlled among the enterprises within a particular cartel, it might still be possible for various cartels to compete with other cartels by offering competing products and services. The "central planning" system may be only a device designed to detect and control such illicit competitive behavior on the industrial level; perhaps preventing the Metallurgy Cartel from competing with the Plastics Cartel, or the Chemical Cartel from competing with the Textile Cartel. Thus, the vaunted "central planning" bureaucracy may only represent something extremely mundane, albeit economically understandable: the central office of an elaborate system of interconnected industrial cartels in the economy.

Summary and Conclusion

This article has argued that the Soviet-style economic system is in actuality not a "socialist" economy at all, but a highly restricted market in which state intervention is almost completely unrestrained by force of law, constitution, or concern for electoral support. Like the mercantilist system in seventeenth-century France, the Soviet economy is characterized by widespread restrictions on competition designed to provide monopoly rents to a favored few. The name of the game is not "rational economic planning," but rent-seeking. The alleged "central planning system" appears to function as a monitor and enforcer of compulsory cartel agreements engineered by the state; the "planning" apparatus functions to protect the holders of monopolistic privileges from the competition of outsiders and also to defend and maintain the monopoly rights from encroachment by *other* monopolists. In this sense only does the "planning system" perform a kind of planning function: it coordinates among different monopolistic enterprises in the sense that it minimizes competitive conflict among them.[9]

Numerous observers of the Soviet system have declared that the ideology of Communism plays no important role today, whether or not it

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ever did.[10] The argument presented here might seem to imply this—but only in relation to those wielding effective political power in the Soviet regime. Ideological commitment to the goals of Marxian socialism may play an important role in bolstering the control of the regime over the general population, as well as protecting a system of mercantilism, which greatly harms the welfare of consumers, from a rebellion by those consumers. Certainly, the regime invests enormous resources in the production and distribution of domestic propaganda; Heller and Nekrich (1986, p. 656) maintain that "the ideological army"—the bureaucracy devoted to propaganda—"surpasses the army, navy, and air force in number." Even if the ideology of socialism is not a primary motivating factor behind the existence of the Soviet economy, it undoubtedly plays an important role in maintaining and perpetuating that regime.

However, we need not assume that the present system is organized by those in power based solely on some fervent commitment to socialistic ideals, without regard to the reality of socialist economic performance. The "ruling class" in the Soviet system are the beneficiaries of a system which generates enormous profits for the few in charge by means of massive governmental restrictions on the process of free competition. □

FOOTNOTES

1. In his recent study of the Soviet economy during the Stalin era, Eugene Zaleski notes that this has been the case since the early 1930s. He writes: "[this] study shows that the existence of . . . a central national plan, coherent and perfect, to be subdivided and implemented at all levels, is only a *myth*. What actually exists, as in any centrally administered economy, is an endless number of plans, constantly evolving, that are coordinated *ex post* after they have been put in operation. The unification of these innumerable plans into a single national plan, supposedly coherent, takes place rarely . . . furthermore, the attempt at unification is only a projection of observed tendencies resulting from extrapolating trends based on natural forces." (1980, p. 484)

He goes on to describe the nature of the plans as "changing and often ephemeral" (*ibid.*).

2. Willis (1985) explains: "High office is often a passport to riches in the three republics of the Caucasus and the five in Central Asia. Large bribes have been reported given to Party officials to extract important *nomenklatura* appointments: the job of Party leader in a district committee had been secured by the payment of between 150,000 and 200,000 rubles to a republican Central Committee functionary in Georgia and Azerbaijan. The position has cost 100,000 rubles, and the job of minister for trade, who controls all retail shops, went for 250,000 rubles." (p. 308)

3. For example, on December 16, 1986, the Chairman of the Communist Party of the Soviet Republic of Kazakhstan, Dinmukhamed Kunaev, was replaced by Gennadi Kolbin following publicity concerning Kunaev's alleged corruption (e.g., private herds of sheep, cattle, and horses on state farms kept for members of the top Kazakhstan leadership, and large sums supposedly taken from state coffers to equip private hunting lodges with saunas, billiard halls and crystal candelabra). This replacement was touted as part of Gorbachev's "anti-corruption" campaign. However, it is also the case that the unfortunate Kunaev was a friend and follower of the late Leonid Brezhnev, and that the luckier Kolbin is a friend and follower of Mikhail Gorbachev. It seems a reasonable guess that if Kolbin had been Party Chairman and had pursued Kunaev's interest in cows and billiards, the Gorbachev campaign against "corruption" probably would have looked somewhere else. See Bohlen (1987, p. 1).

4. Harris (1986, pp. 24-30) lists numerous examples of "socialist graft" (extraction of monopoly rent by those in official positions) in the People's Republic of China, which are generally similar in nature to the examples from the Soviet Union cited above.

5. In practice, enterprises in the Soviet economy normally depend on the services of second economy operatives, known as *tolkachi* (literally, "dealers") who overcome supply problems by the use of bribery and/or *blat* (non-pecuniary bribes such as favors, presents, etc.). The *tolkach* of the enterprise in effect markets its output and purchases the output of other firms "under the table." Although the magnitude of this activity is impossible to measure precisely, the *tolkachi* seem to play an extremely important role in the economy. Berliner (1957, p. 224) quotes the head of a food-processing combine he interviewed as declaring of the *tolkach* that "[he is] irreplaceable. We live with him as if in Christ's bosom." For discussions of the *tolkachi* and their importance, see Berliner (1957, pp. 220-231; 1976, pp. 73-76), Kaiser (1984), and Nove (1977).

6. However, it apparently is the case that the top leadership not only retains ultimate authority over the selection of personnel for both governmental and industrial posts (managers, etc.) but sometimes even makes the actual selections. For instance, Stalin is known to have often directly selected relatively low level personnel. See Goldman (1983, p. 22).

7. The Communist Party excercises control over managerial appointments in a number of ways. Every Communist who changes his job can do so only with the approval of his "raikom" (Party district committee). In the Soviet Union the majority of enterprise managers are members of the Party; it is highly unusual for a manager of any but the smallest enterprises not to be. Every Party organization is responsible for creating a "managerial reserve," that is, a list of people who are potentially "suitable" for managerial careers; and Party organs have the right of veto over all appointments made to posts listed in the *nomenklatura*. See Hough (1969, Chapters 1 and 2), and Voslensky (1984, Chapter 3).

8. Andrle (1976, p. 102) quotes a 1968 Soviet official publication's description of the activity of industrial "instructors" of the Communist Party: "Preparing reports for the bureau and the plenum, sending trucks to a harvest, organizing city celebrations and improving city amenities, procuring supplies for enterprises . . . and hundreds of other problems have to be dealt with without delay. One plant needs help with the overhaul of a motor because it has no suitable workshop; another needs a big boiler transported, but the necessary cranes and vehicles are in the possession and intensive use of building organizations . . . [etc., etc.]"

9. This is consistent with Voslensky's interpretation of the Soviet system. Arguing that the Soviet economy is a "syndicate," or an "ultramonopoly" created by State coercion, he writes: "The nomenklatura class exercises unlimited sway over the huge syndicate of which the Soviet economy consists. That is the principal feature of the country's economic organization. *Nevertheless, the outside world goes on believing that its chief characteristic is economic planning.*" (1984, pp. 127-128; italics added)

10. For example, Nove (1977, p. 10) writes: "Probably most analysts would agree that ideology (i.e., Marxism-Leninism) is not a powerful force in the Soviet Union today."

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Peking Duck or Kentucky Fried?

by Lawrence W. Reed

Mao Tse-tung, the man whose 1949 revolution brought communism to China, once launched a nationwide "Four Pests" campaign. Part of the effort was designed to eradicate houseflies by having every Chinese meet a quota of swatting at least 10 flies a day.

Now years later, as the "Great Helmsman" rests in peace in Beijing's Tiananmen Square, China still has plenty of flies. But something that would undoubtedly disturb Mao far more, if he only knew it, is on view just across the street from his mausoleum: the smiling face of Colonel Harlan Sanders.

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KENTUCKY FRIED CHICKEN/BEIJING

In November of 1987, Beijing became the site of the world's largest Kentucky Fried Chicken restaurant. The 500-seat fast-food eatery is the latest monument to the policies of Deng Xiaoping, under whose leadership post-Mao China has been moving away from three decades of radical isolation and doctrinaire Marxist control of the economy. In Beijing, at least, *glasnost* is finger-lickin' good.

Store manager Khaw Swee Kwang reports the place serves an average of 1,000 meals on weekdays and nearly double that on weekends. Two- and three-piece chicken dinners sell at prices comparable to what Americans pay here. The chain is negotiating with the government to open other outlets.

Strict quality control assures the taste is no different from that in the American outlets.The chickens are raised on farms outside the capital to Kentucky Fried Chicken's exacting specifications. Ditto the potatoes and cabbage. Only the famous "11 herbs and spices," a trade secret, are imported.

In an interview, Khaw made it plain that running such a capitalist establishment in a communist country has been profitable but not easy. The Chinese government, for instance, insists on majority ownership. Kentucky Fried Chicken's share is limited to 40 per cent.

The management must eventually be predominantly Chinese. Khaw himself is from Singapore (which boasts 31 Kentucky Fried Chicken outlets) and will leave Beijing when his mission to train Chinese managers is completed.

Workers drawn from the local labor pool present a major challenge. The so-called "iron rice bowl," a Maoist notion that each worker should have a secure, lifetime job (an unbreakable rice bowl), has become so much a part of Chinese life that workers must be taught that merely showing up for work is not enough. They must learn a new ethic centered around the capitalist notion that "the customer is always right."

"It's always been difficult to teach them to really care, to go the extra mile in keeping customers happy," Khaw says. By prior arrangement with the government, the restaurant is permitted to fire unsatisfactory employees. The mere prospect, according to management, has been a "powerful incentive."

Employee wages are fixed by the government, which is anxious to avoid being embarrassed by a foreign capitalist enterprise's paying more than its domestic counterparts. Because high morale and better performance incentives are important to Kentucky Fried Chicken, the management has found the low-wage scale too stingy and restrictive. The problem is partly circumvented with occasional bonuses "paid" in fried chicken.

The restaurant is also experiencing another problem, the same energy hassle that afflicts all buildings in Beijing. The state-owned utility refuses to supply any heat before November 15. It's shut off on March 15 regardless of the weather. The city often endures below freezing temperatures into April.

Patrons like the restaurant not only for the food and the colorful, well-lighted surroundings, but for its American aura as well. More than a few will tell the visiting foreigner that eating there is as close as they are likely ever to come to fulfilling their dream of seeing the United States.

Somebody once said the formula for rolling back the communists calls for bombarding them with capitalist mail-order catalogs, video tapes, and fast food. If so, Colonel Sanders may be one of America's more cost-effective weapons. □

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Perestroika: Can It Work?

by Manuel F. Ayau and Julio Cole

It is all very well to hail *perestroika*—the current moves toward liberalization of Soviet bloc economies, the establishment of "profits" as incentives for Soviet managers, and steps to organize Soviet production is a more businesslike manner. But all these changes soon will bring disappointment, for technical reasons.

It isn't enough to imitate the marketplace. The essential ingredient of a market economy is the private ownership of scarce resources and the means of production. And even with *perestroika* this ingredient is missing.

The technical reasons have to do with a problem which continues to be ignored by most people, and indeed by most economics professors. In the 1930s, when it was debated in small intellectual circles in Europe, it was called the Problem of Economic Calculation.

Simply stated, we live in a world of scarcity, and no matter how a society is organized, we always will need some means of deciding how resources can be put to the best use. In a capitalist society, free market prices provide the answer. Competition among buyers and sellers in a free market established relative prices which eliminate the least economic (least profitable) uses of each particular unit of a resource, inducing the use of substitutes which in turn must be withdrawn from other uses by the same marketplace process. All of this happens only because resources and the means of production are privately owned—they can be bought and sold and consequently have market prices. How this happens is amply explained in economics texts, although seldom are students reminded that it happens only in economies with private ownership.

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Problems of Allocation

What has yet to be explained is how a true socialist society (one that doesn't copy capitalist prices) could carry out this necessary task of efficient allocation. Ration cards, queues, and income controls are used today in so-called socialist countries, along with arbitrarily determined shadow prices, to ration consumer goods. But how would the planning czar determine how best to use, say, one additional pound of silver when confronted with such competing uses as more X-ray film, industrial film, microfilm for banks, tourist film, jewelry, electronic contacts, tooth fillings, and wart removals? Remember that he also would have to decide on the price relationships of all the inputs used to produce the pound of silver, as well as the prices of all the things of which it becomes a part. And we must bear in mind that he cannot simply sum up the costs, since costs themselves are prices.

The problem of economic calculation was brought to the attention of the academic community by Ludwig von Mises in 1920. In referring to Mises, the famous socialist theoretician Oskar Lange wrote in 1936, "it was his powerful challenge that forced the socialists to recognize the importance of an adequate system of economic accounting to guide the allocation of resources in a socialist economy. Even more, it was chiefly due to Professor Mises' challenge that many socialists became aware of the very existence of such a problem. . . . the merit of having caused the socialists to approach this problem systematically belongs entirely to Professor Mises. Both as an expression of recognition for the great service rendered by him and as a memento of the prime importance of sound economic accounting, a statue of Professor Mises ought to occupy an honorable place in

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the great hall of the Ministry of Socialization or of the Central Planning Board of the socialist state."[1]

The nature of the problem of economic calculation is that of assigning relative prices to millions upon millions of items, each of whose price is a function of all other prices, with the ultimate deciding factor for each price being the ever-changing subjective valuations of millions of consumers.

Though it is sometimes useful conceptually to represent the economic problem as a system of simultaneous equations, solvable "in principle" by an omniscient central authority, it is utterly naive to assume that even the simplest problems could actually be solved even in this era of supercomputers. Toward the end of the last century, Italian economist Vilfredo Pareto showed that a simple "economy" involving only 100 people and 700 goods required the solution of 70,669 equations. The fantastic number of equations involved in the more realistic case of millions of people and millions of goods is mind-boggling. And this mathematical approach completely overlooks the subjective and therefore unmeasurable nature of consumer valuations, as well as the critical role of entrepreneurs who strive to discover and meet changing consumer needs and wishes.

Even assuming that the "Central Authority" could paternalistically decide upon the proportions of final consumer goods to be produced (i.e., how much of each commodity is "good" for the people), the main problem is how to produce the desired outputs—determining which of the myriad of technically feasible input "mixtures" is most efficient. The fact that the leading Soviet planning theorist, L. Kantorovich, managed to discover the problem in 1939 is one of the most curious incidents in the history of modern economics. He found that the correct solution of a production problem given several inputs and several possible input combinations, required the introduction of certain auxiliary variables which he called "allocation coefficients." As it turned out, when Western economists read his paper after the war, they realized that these "allocation coefficients" were simply the prices of the different inputs.[2]

Because we live in a world where things have prices, we take them for granted. But market theory teaches us that prices are not established by "someone" or by some "authority." They arise from private exchange decisions made at the margin. It is the marginal buyer and the marginal seller who determine the market-clearing price. Socialist economic theory is based on the principle that values are objectively determined, so there can be no such thing as "the margin." The concept of "marginal rates of substitution" can have meaning in the determination of prices only where resources and the means of production are privately owned. And this excludes socialism.

What this boils down to is that no one has ever explained how socialism is supposed to work. (As an aside, it is worth noting that this is a very disturbing and serious matter, when one thinks of an academic world that grants recognition and prestige to people who unabashedly claim to be in favor of a system yet to be described!) Just because some totalitarian countries call themselves "socialist" does not mean that they actually operate in a socialist manner. If you are wondering how "socialist" countries go about setting their prices, it is simple: they copy them from capitalist countries, from Sears' catalogues, and from newspapers, adjusting them to their current plans. And whereas profit incentives are important motivationally, they are useless if decision makers lack the information to be able to economize resources and achieve efficiency.[3]

Myths die hard, and the myth of the feasibility of central planning is no exception. Failures will be blamed on people, on sabotage, and on the weather. Revolutionary new corrective measures again will be announced. Stay tuned: the new *perestroika* is coming. □

1. Oskar Lange and Fred M. Taylor, *On the Economic Theory of Socialism* (New York: McGraw-Hill, 1964), pp. 57-58.

2. Kantorvich had stumbled upon the technique of linear programming, which in the meantime had been independently discovered in the West by G. Dantzig and T. Koopmans, where it has been successfully applied to a wide variety of management problems. Ironically, it has been applied in socialist planning, for one simple reason. Linear programming is a way to determine the most efficient solution of a production problem for a given set of input prices. Of course, for any arbitrary set of prices there is a corresponding "best" solution. However, there is no way of knowing whether this "best" solution is in fact the true optimum unless the original input prices themselves are optimal.

3. For a detailed treatment of the problem of economic calculation, see Don Lavoie, *National Economic Planning: What Is Left?* (Cambridge, Mass.: Ballinger, 1985).

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How to Solve the Debt Crisis

by Christopher L. Culp

The world is in the midst of a debt crisis, though much of the U.S. financial sector has employed extensive rhetoric and artful accounting to avoid admitting it. The world first became aware that there was a problem when the Mexican government informed American banks in August 1982 that it was unable to pay the interest on its loans. By 1987, the problem had compounded. Peru had proclaimed that it would devote no more than ten per cent of its total export earnings to interest payments, and several countries such as Bolivia and Brazil, in effect, had defaulted.

The U.S. financial sector greatly fears the word "default," so it employs tidy euphemisms such as "restructure" to avoid acknowledging that most debtors cannot repay their loans. American banks might do well to remember the proverb: If a bank loans out a thousand dollars and the debtor defaults, the debtor is in trouble; but if a bank lends a hundred million dollars and the debtor defaults, the *bank* is in trouble.

If a bank holds more liabilities than assets, there is a risk of bank insolvency precipitated by "confidence problems." When a debtor nation refuses to pay interest on a loan, it makes it impossible for the lending bank to balance its account. However, to avoid taking losses, banks have engaged in the deceptive process of manipulative accounting. If a debtor nation owes a bank $50 million in interest and the country cannot pay it, rather than writing off the loan as unrecoverable, the bank lends the debtor $50 million more to pay off its interest obligation. However, there is interest on that additional loan. Since the debtor could not make the interest payment in the first place, there is little reason to think that it will be able to pay the interest on the additional loan, much less the premium. The ensuing cycle is painfully obvious.

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Unsustainable Debt

Unsustainable debt seems to be the case more often than not in the Third World. This problem is magnified by the fact that most lending institutions within developing countries are plagued by problems of illiquidity and insolvency. This financial crisis causes a serious distortion in the incentive structure for the Third World financial sector, in many ways similar to the recent U.S savings and loan debacle. Once a lending institution is insolvent, it is apt to take greater risks and make more questionable loans. This only aggravates concerns about bankruptcy or bank bailouts. Continued uncertainty inevitably leads to further financial crises as investors begin to doubt the ability of banks to provide liquidity.

Sir Alan A. Walters, former Economic Advisor to British Prime Minister Thatcher, describes this problem as "absolutely critical" because it makes the debt dilemma increasingly harder to solve as time goes on.[1] Furthermore, developing nations are typically becoming more heavily indebted without showing signs

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of significant capital growth. From 1982 to 1986, gross capital formation as a per cent of GDP in heavily indebted countries dropped from 22.3 per cent to 16.8 per cent. At the same time, the debt-export ratios of these indebted countries rose from 269.8 to 337.9.[2]

As if the duplicity evident in the official balance sheets of many U.S. banks wasn't enough, the American financial sector has been recklessly irresponsible in its lending practices. Many banks have loaned far more than their equity. Consequently, when debtors cannot make their interest payments, such banks' liabilities will become greater than their assets. Their resulting insolvency will leave these banks unable to guarantee the assets of American investors. Enter the Federal Deposit Insurance Corporation, to rescue the failed banks. But what happens if, unlikely though it may seem, all the debtors default and their creditor banks become insolvent? The entire U.S. financial infrastructure is threatened.

Obviously, the U.S. financial sector wants to avoid this overly pessimistic scenario. Rather than face reality, though, American lending institutions simply resort to a policy of dishonorable accounting to temporarily alleviate the imbalance between assets and liabilities. However, the banks are only fooling themselves. Creative bookkeeping may work in the short term, but the problem of increasingly unsustainable loan exposure will continue, necessitating a solution at some point in the future when the problem is much greater.

Not all U.S. banks have perpetuated the illusion that all is well. John Reed of Citicorp decided in May 1987 to write-down his institution's Third World loans to their actual value and simply absorb the loss. He then increased Citicorp's debt-to-reserve ratio. Reed's actions were six years late in coming, but by June 1987, 43 of the 50 largest U.S. bank holding companies had engaged in similar measures.

Citibank took an important step in starting to pull the U.S. out of the debt crevasse, but its actions and the subsequent actions of other banks cannot solve the crisis. To avert a Third World debt "disaster," it is necessary to address the underlying issue of irresponsible lending *and* to stimulate growth in developing countries. While irresponsible lending is certainly a problem in the short term, it is the much greater problem of Third World underdevelopment that makes the debt crisis intractable under current systemic constraints. The most obvious solution to the crisis, then, is to facilitate development in less developed countries and improve their ability to repay their debt obligations.

The private sector not only provides a means of averting a short-term disaster, but addresses the far greater need of preventing future crises in lending. Three key measures will quell the financial storms and brighten the lending horizon: (1) securitization of outstanding U.S. loans; (2) implementation of debt/equity swaps with debtor nations; and (3) privatization of state-owned enterprises in developing countries.

Securitization of Debt

The first necessary step in allowing the free market to get the world out of the debt trap is to prevent reckless bankers, who are far more concerned about their corporate reputation than the integrity of the U.S. financial system, from continually "restructuring" outstanding, unrecoverable loans. In short, banks need to take their losses for what they are.

Simply because a country cannot pay back its entire loan does not mean that it cannot pay back a part of it. The task becomes one of establishing how much of the outstanding bank loan is irretrievable. This can be done easily by "securitizing" the loan, or selling it on the open market. In securitizing debt, a bank merely converts part of its loan into bonds backed by outstanding debt. The primary function of this action is to establish a "market price for the debt." Securitization allows the market to facilitate bank actions such as Citibank's that determine the present value (in real dollars) of problem loans to the Third World.

Dollars loaned to different countries have different market values, depending on the specific country's ability to repay. For example, if a bank holds a $2 billion loan to Argentina, it is very unlikely that it will ever get the full $2 billion back. Rather than perpetuating the problem by allowing a banker to make additional loans to Argentina in order to sustain its

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ability to make interest payments, the bank can literally sell part of its outstanding debt by issuing bonds. By offering the sale of, for example, 1,000 bonds at $100,000 each (5 per cent of the total loan), the bank can effectively determine the current market value for the loan to Argentina.

If these bonds sell at $50,000 each on the open market, then the market value of each dollar loaned to Argentina is at a 50 per cent discount. Once this has been determined, the bank discounts its entire $2 billion loan on the balance sheet to its market value, $1 billion. The bank has lost $1 billion rather than $2 billion (still no small sum).

Since investors will buy the bonds at a price consistent with the ability of Argentina to repay the loan, the bank now has a loan that *can* be sustained and repaid by Argentina. Even though the bank has lost a considerable amount of money outright, it now holds a loan that can be repaid, rather than one that must continually be "restructured" or hidden by fictional accounting. There are a number of notable benefits to this process of securitizing loans.

First, it decreases (at least marginally) the risk of default by discounting the loan to a value that can be repaid by the debtor nation. Consequently, the total debt exposure of the nation is reduced.

Second, by selling debt bonds, the risks of default are spread among many investors. Investors will not buy debt bonds unless they see some potential for gain, so the transfer of risk is strictly voluntary. The risk of default is currently held nominally and involuntarily by the American taxpayers, in their support of FDIC guarantees. Securitizing a loan transfers those same risks currently financed by taxpayers to those investors willing to take them.

Third, securitization liquifies the assets of the bank's portfolio by creating convertibility on the secondary market. Furthermore, securitization gives the indebted country an opportunity to literally buy back its own debt at a discount.

Fourth, securitization restores "truth in accounting." It allows the banks to determine the real market value of debt, cut their losses outright, and consequently reduce the risk of long-term insolvency.[3]

Debt/Equity Swaps

The second way that the private sector can eliminate the debt crisis concentrates not on lending practices, but on the borrower's ability to repay. Increasing the real rate of growth in a debtor nation means its debt can eventually become sustainable. Part of the problem in the current low growth rate of heavily indebted nations is the phenomenon of capital flight precipitated by low or negative rates of return on investments. When the return on an investment is particularly low in a developing nation, its citizens will invest their capital elsewhere.

For example, a bank in the U.S. makes a loan to the government of Argentina in order to foster development. The Argentine government dispenses the money to the private sector, but because the rate of return is so low, private investors merely place the money in U.S. banks. The result is that the government of Argentina owes money that it cannot repay to American banks, and the Argentine economy has nothing to show for it. The loan money, intended to develop Argentina, is sitting in U.S. banks, out of reach of both the Argentine government and its original U.S. lenders.

Until investment can be made profitable in developing nations, their rates of growth will not improve. Debt-for-equity swaps are an effective means of both facilitating growth and contributing to the reversal of capital flight. Such swaps involve the exchange of foreign debt for local equity and have numerous economic benefits.

The success of Chile in this area helps prove the efficacy of debt/equity swaps. In 1986, the market value of Chilean debt denominated in dollars was approximately 67 per cent of its face value (i.e., it was trading on the secondary loan market at a 33 per cent discount). However, its market value was approximately 92 per cent of its original value when denominated in pesos, since most Chilean investors, unlike U.S. bankers, believed that the debt was sustainable.

Loans must be repaid to U.S. banks in dollars, but local equity is denominated in pesos. Consequently, in 1985 Chile changed some of its foreign exchange regulations to encourage debt/equity swaps so that investors

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could take advantage of this opportunity for intermarket arbitrage (the purchase and sale of a security on two different markets for the purpose of capitalizing on price discrepancies between different exchange rates) and thereby improve the Chilean investment climate.

Johns Hopkins University economist Steve H. Hanke states that debt/equity swaps are "aimed at investors who wish to purchase external Chilean debt for the purpose of capitalizing it into investments in Chile."[4] The prospect of converting foreign debt into local equity not only has attracted foreign investment to Chile, but it has stimulated the repatriation of Chilean flight capital. In two years, Chile reduced its debt obligation by four to five per cent. As of November 1987, Chile had converted approximately $1.2 billion in debt into local equity.[5]

Encouraging these swaps will enhance the development of capital markets in indebted countries. By increasing capital flows into an indebted nation, its growth rate will increase, eventually raising the rate of return. Debt/equity swaps are an excellent means of reducing the loan exposure of a debtor nation while also stimulating economic development.[6]

Privatization

A third means of decreasing the developing world's debt obligation is to reduce the size of the public sector in the economy of developing nations so as to stimulate growth and development. The elimination of state-owned enterprises in debtor nations will strengthen their economies by promoting the development of capital markets. Privatization also will decrease public sector expenditures and improve economic efficiency.

Presently, state-owned enterprises are characterized by insatiable demands for continuing subsidies, bloated payrolls, low employee performance, high costs of debt servicing, and underutilized capital.[7] They typically allocate resources in a very inefficient manner and respond poorly to consumer demands. Transferring state-owned enterprises to the private sector not only will tend to eliminate negative cash flows, but also will stimulate growth by providing opportunities for debt/equity swaps and increasing the economy's productive efficiency.

Privatizing state-owned enterprises also promotes popular capitalism through wider share ownership. Furthermore, it strengthens existing capital markets in developing nations by making such markets more liquid. Indeed, privatizing by open stock sale can actually *create* capital markets where previously there were none. Capital market development promotes economic development because capital market liquidity narrows the gap between what a consumer offers to pay for a good and what a producer charges for it, known as the bid-ask spread. In nations without capital markets, it is often the case that particular goods cannot be sold because bids are so much lower than the prices asked, largely due to informational deficiencies in the economy. Liquid capital markets help alleviate this problem.

Privatization, by promoting a liquid capital market through wider share availability, facilitates economic growth and development. Furthermore, by increasing the role of the private sector and limiting state involvement, an important signal is sent to foreign lenders that efforts are being made to improve real domestic rates of return on investments. In this way, privatization promotes foreign investment and the repatriation of flight capital.

However, obstacles to privatizing state-owned enterprises come in many forms. Privatization is a very complicated process which requires economic liberalization to ensure competition, and the preservation of property rights to mitigate against the threat of expropriation. This is often difficult because of the political instability common in most heavily indebted nations. Many Third World leaders feel that a stronger private sector would jeopardize their political supremacy, and they consequently oppose privatization.

Although most political opposition to privatization is founded on misconceptions, disproving these misconceptions is often very difficult. The U.S. financial sector certainly has not helped matters. Because of its unwillingness to acknowledge *de facto* financial losses already incurred, American banks are allowing the developing world effectively to hold the U.S. financial system hostage. Reckless

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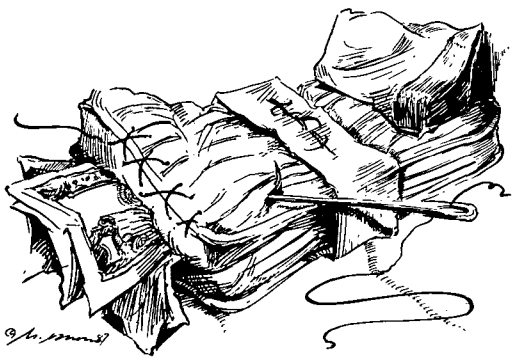

lending coupled with irresponsible use of loan money by Third World governments has led to an escalating problem, most of which is purely political: the Third World's unwillingness to compromise or liberalize, and the U.S. financial sector's unwillingness to use its better judgment in lending practices.

As Heritage Foundation's privatization expert Stuart Butler observes, "Privatization, like nationalization, is first and foremost a political exercise."[8] A key step in privatizing state-owned enterprises is simply to convince politicians that privatization works. However, as long as the Third World meets with little or no opposition in its tactics of financial blackmail directed at the banking industry, its leaders have no reason even to bother with liberalization and privatization. To many of them, it is simply a risk that they do not have to take.

Deregulating the U.S. financial sector is a virtual necessity for the long-term elimination of the debt crisis. Banks have irresponsibly overextended their equity and "fixed" their balance sheets primarily because the market does not hold them accountable for their actions. American lending institutions must be made responsible to economic realities. Instituting a system of "mark to market" accounting and regularly evaluating the equity of banks can make them accountable to market risks. Under this system, if a bank becomes insolvent, it *immediately* will be closed, removing the need for the taxpayer-funded insurance system (the FDIC).

Any long-term solution to the debt crisis eventually requires accountability in finance. Securitizing debt enables the banks to determine the real value of their loans and to "cut their losses." Upon cutting their losses, a new system of mark to market accounting will ensure that banks no longer make loans they cannot guarantee. Securitization also allows investors voluntarily to assume part of the banks' risk of loan default, thereby removing the burden from the unconsulted taxpayer.

Through securitization and financial sector deregulation, the banking system of the United States will be held accountable to the market. The long-term solution to the debt crisis then comes from stimulating growth and development within debtor nations. Through debt/equity swaps and the privatization of state-owned enterprises, capital market development is promoted. Then, the real rate of growth can be raised to make Third World debt sustainable.

The debt crisis can be solved. But until U.S. lending institutions decide to confront the crisis it will continue to escalate. Citibank and many others have made steps in the right direction. Indeed, it is true that most banks have markedly improved their loan portolios in the last few years. But the current financial system could easily aggravate existing problems. Until the system is changed, recurrent crises in lending will continue to be an underlying threat. □

1. Sir Alan A. Walters, before "Capital Markets and Development," part of the seminar series "Including the Excluded: Extending the Benefits of Development," sponsored by the Sequoia Institute, Washington, D.C. June 3, 1988.

2. The heavily indebted countries referred to in this data are Argentina, Bolivia, Brazil, Chile, Colombia, Côte d'Ivoire, Ecuador, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, and Yugoslavia.

This data comes from the International Monetary Fund, *World Economic Outlook,* April 1987.

3. I am grateful to Sir Alan A. Walters for his insights on securitization. He is, however, blameless for the above views.

4. Steve H. Hanke, "Chilean Flight Capital Takes a Return Trip," *Wall Street Journal,* November 7, 1986.

5. Peter A. Thomas, "Debt Equity Swaps: A Review of an Underutilized Privatization Mechanism" (Washington, D.C.: Center for Privatization, November 1987), p. 3.

6. The positive effects of debt/equity swaps can, however, be lessened by the intervention of non-market forces. With the exception of Chile, all Latin American nations which have engaged in debt/equity swaps to date have witnessed government intervention in the process. Often, the host governments either inform investors which equity investments may be considered for conversion, or they approve each investment on a yes/no basis. In either case, the government has the final say in determining which equity investments are candidates for these swaps.

It should also be noted that, while government intervention in Chilean debt/equity swaps is much less pervasive than in other Latin American nations, the government does play an active role in the process. Internal conversions of debt to equity, for example, have restrictions on the total amount of debt that can be converted by investors, primarily to prevent massive expansion of the money supply.

7. "Why Privatize?" (Center for Privatization: Washington, D.C.), May 15, 1987, p. 6.

8. Stuart Butler, "How to Privatize the Postal Service," before the Cato Institute, April 7, 1988, p. 2.

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A REVIEWER'S
NOTEBOOK

The American Conservative Movement

by John Chamberlain

Before he was elected to the U.S. Senate, the late John P. East of North Carolina was a professor of political science. A man of great scholarly attainments, he took time out from active politicking to produce a book, *The American Conservative Movement* (Washington, D.C.: Regnery, 279 pp., $18.95), about the seminal thinkers he considered most responsible for the resurgence of the American conservative movement. His choices were seven scholars: Russell Kirk, Richard Weaver, Frank Meyer, Willmoore Kendall, Leo Strauss, Eric Voegelin, and Ludwig von Mises.

In investigating his seven choices, East discovered that they had a most important common religious denominator. They were one with Plato in accepting the certainty of a mysterious creator who was responsible for man as he is, a creature capable of "ascent" but also prone to lapses. Some of the seven were Christians, some preferred to let their belief in a creator stand without reference to Christ and the Incarnation. As for Mises, who wrote purely as an economist, he said his classical liberalism had never pretended to be more than a philosophy of earthly life. Even so, he said "it is not to be denied that the loftiest theme that human thought can set for itself is reflection on ultimate questions . . . the liberals do not disdain the intellectual and spiritual aspirations of man."

Since Senator East's seven thought as one on first principles, there is an inevitable repetition in their biographies. But the surprising thing is that minor differences make for some rather exciting cross currents of argument.

Frank Meyer, for example, who became a Roman Catholic before his death, had bones to pick with Russell Kirk on the subject of Edmund Burke. He conceded that Burke was right in standing against the excesses of the French Revolution. But if Burke had lived at the time of the so-called Glorious Revolution in the Britain of 1688, he would have been wrong to stand on what Meyer calls "the multitudinous wrappings of code and custom."

The New Conservative, said Meyer, "is shaped by such words as 'Authority,' 'order,' 'community,' 'duty,' 'obedience.' 'Freedom' is a rare word; 'the individual' is anathema. The realities of this suggested society are a mixture of those of eighteenth century England and medieval Europe—or perhaps, more aptly, they are those of Plato's Republic with the philosopher-king replaced by the squire and the vicar."

For all his contentiousness, Frank Meyer took it upon himself to hold libertarians, classical liberals, and conservatives old and new together when they went to the polls. East doesn't think Meyer should be called a "fusionist" (he was, at the last, a Christian thinker). But he realized that there were practicalities involved when it came to elections.

Willmoore Kendall was another fractious soul when it came to differing with colleagues on subservient matters. A believer in close textual analysis, Kendall was convinced that John Locke, the instigator of the peaceful 1688 re-

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volt against the arbitrary Stuart kings, was a "majoritarian." That was enough to damn Locke in Kendall's eyes. But the American Founding Fathers, who, like Locke, were fighting the presumption of a king to tax as he chose, were not worried by Locke's majoritarian views. They were sure that, with proper exemptions in a Bill of Rights, no majority would ever dare to discriminate against minorities in a way that might deny the "rights of Englishmen."

Leo Strauss of the University of Chicago set innumerable students to thinking about their political institutions. Strauss's concern was for a "spirit" that might be described as "serenity" or "sublime sobriety." He talked of "piety" as the "humble wonder at mystery." The good citizen, in Strauss's view, should dedicate himself to "piety and service."

Tossing the word "service" into the argument must lead to some confusion. The entrepreneur, as Adam Smith insisted, was more often than not a serviceable entity to all of humanity even when he was dominated by selfish aims.

George Nash, who contributes an introduction to Senator East's book, speaks of East's desire to recall American conservatives to their religious roots. Hence the common denominator of picking a religiously motivated six, and a fellow traveler (Mises), for special study. What bothers me about the selection of the seven is that they were not the pioneers of the American conservative movement. I caught up with the seven after an early contact with Henry Hazlitt, Max Eastman, Don Levine, Frank Chodorov, Whittaker Chambers, Leonard Read, Isabel Paterson, Rose Wilder Lane, Ayn Rand, Garet Garrett, Claude Robinson, and Murray Rothbard. The list is long, and could be made longer.

Nash says of East that he would be the first to acknowledge that his seven "were not the only architects of the conservative renascence." East, says Nash, favored his seven because they "did the most to infuse American conservatism with intellectual substance and coherence—who made it, in short, a formidable movement of ideas."

One does not cavil with the statement that Willmoore Kendall, Frank Meyer, and the rest of the seven had "substance" and "coherence." But to imply that Henry Hazlitt, for instance, had less to do with infusing the conservative movement with substance and coherence than Kendall or Meyer is simply to create a one-sided impression. Hazlitt's *Economics in One Lesson,* a perennial best-seller, is certainly full of substance and reads with a beautiful coherence.

I like to give pioneers their special due. I like to recall that Don Levine's *Plain Talk* magazine printed a map of the Russian Gulag long before Solzhenitsyn became a household word. I like to remember the work of William Henry Chamberlin in exposing the man-made famine of 1930 in Stalin's Russia. He certainly changed minds about Communism. American conservatism has had many roots, some of them religious, some not. Even atheists (Max Eastman and Ayn Rand) have contributed to it. □

COGS IN THE WHEEL: THE FORMATION OF SOVIET MAN

by Mikhail Heller

Alfred A. Knopf, Inc., 400 Hahn Road, Westminster, MD 21157
1988 • 293 pp., $22.95 cloth.

Reviewed by Richard M. Ebeling

A sentiment commonly heard in recent discussions concerning future Soviet-American relations is that conflict and tension are inevitable unless these two "great nations" are able to "understand" one another. The presumption is that ignorance breeds fear and war, while knowledge creates a bond of mutual respect and peaceful relationships.

It is certainly true that, even in the new era of *glasnost* in Gorbachev's Russia, the people of the Soviet Union are still limited in the information and ideas they are permitted to receive from the West. In the West, on the other hand, the situation is different. The information available about the Soviet system is vast, but often what gets filtered through the news media is a Soviet Russia seen through rose-colored

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glasses: they are really just like us, only different. This is supposed to mean that the Soviets really want the same things we in the West desire—peace, prosperity, justice; it's just that they sometimes use methods that seem a bit brutal by our more sensitive Western standards. If only we could humanize them a little. . . .

Mikhail Heller's recent book, *Cogs in the Wheel: The Formation of Soviet Man,* forcefully argues that an understanding of the Soviet Union requires an appreciation that, from the inception of the Soviet State in 1917, not only the means chosen were different from those in the West, but also the ideological ends for which the power of government has been applied are different. Nationalization of the means of production by Lenin and the Bolsheviks was a tool for a specific purpose: to control all aspects of the social and economic environment so as to create the conditions necessary to make over human nature and produce a new Soviet or Communist Man.

Believing, as good Marxists do, that man is a product of his material environment, the Russian Communists had a vision of a new human being: selfless in character, collectivist in orientation, boundless in his love of labor for the common good, and heroic in his defense of the revolutionary cause. But what Lenin and the Bolsheviks found after the Revolution was a Russian people imbued with the same "bourgeois" traits as everyone else: individuals primarily looking out for number one, more interested in improving the economic conditions of their immediate family, reluctant to work except for incentives and rewards for the labor to be performed, and generally disinterested in making sacrifices for a world revolution.

To achieve their goal, therefore, Professor Heller explains, the Communist Party proceeded to destroy all the cultural and economic institutional structures that surrounded and protected the Russian people. As the author expresses it, the Soviet authorities began a process to "infantilize" every Russian, i.e., to make every Russian completely dependent upon the Soviet State, and, therefore, moldable in a social cast constructed by the Party elite. No corner in the society would be left in which the individual could hide and protect any personal qualities and characteristics undesigned by the State.

In one of the most intriguing chapters, Professor Heller argues that the introduction of the "Five Year Plan" served as an instrument enabling the Party to control the very concept and boundaries of time. All conceptions of temporal horizons, beginnings and endings, goals and intermediary points, were defined in terms of the clock of the plan. The Party could accelerate time (by meeting the plan's goals ahead of schedule), apportion time (by subdividing the plan into weekly, monthly, or yearly production quota periods), and change time (by shortening or lengthening the plan's horizon). By manipulating time and the plans within it, the Party could perform miracles before the eyes of "the masses"; by juggling the numbers and massaging the facts of production, the Party could make it appear as though the laws of nature were subordinate to it.

In the new social order, the individual could have no existence outside of the State—no plans, no identity, no sense of self other than his place as an assigned cog in "the people's" machine.

After explaining the goals and strategies for making the new Soviet Man, Professor Heller methodically describes the techniques: the introduction of fear through an omnipresent and omniscient secret police; the control of labor through internal passports and the State as monopoly employer; the breeding of guilt through corruption, as the black market became a primary avenue for survival; the control of minds through an educational system that intrudes beyond the classroom to the family itself; the planning of culture via Party domination of literature and art; and the manipulation of language and, therefore, thought by a constant bombardment of slogans, phrases, and images that make it difficult to think of words or concepts other than in terms of the meanings bestowed upon them by Party ideology.

In his earlier work, *Utopia in Power* (co-authored with Aleksandr M. Nekrich), Heller exhaustively and impressively traced the history of the Soviet Union. Now, in *Cogs in the Wheel,* he helps complete that picture with a portrait of the cultural and human order Soviet power has produced. Through it, we see that

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the Soviets *are not* the same as we are. Those who rule in the Soviet Union have a design different from the Western ideals of a free society. While 70 years of Marxist rule may not have replaced human nature with a new Soviet Man, it *has* influenced the minds of the Russian people. This is seen even in those most recent documentaries on Soviet life in which Western camera crews are approached by ordinary Russians on the street and asked, "Who has permitted this?" What is not explicitly permitted is strictly forbidden. For many Russians, "freedom" only means knowing the difference. And the Party's telling people that they can now have more freedom of expression and action under *glasnost* does not imply that the words will be immediately translated into Western meanings in the minds of the Russian populace. □

Professor Ebeling holds the Ludwig von Mises Chair in Economics at Hillsdale College.

CHANGING COURSE: CIVIL RIGHTS AT THE CROSSROADS
by Clint Bolick

Transaction Books, Rutgers University, New Brunswick, New Jersey 08903 • 1988 • 152 pp., $24.95 cloth.

Reviewed by Carl Helstrom

The civil rights movement in the United States has undergone radical changes in the past 20 years. Following the death of Martin Luther King, the movement deteriorated into a loose-knit faction that claims to advance the ideas of earlier leaders. In reality, the movement has swung full circle to work against the original design.

Clint Bolick, who has served as counsel in several leading civil rights cases, has written a book which could go a long way toward bringing the civil rights movement back on course. The book has two parts. The first contains a brief, yet penetrating, history of civil rights in America. In the second part, Bolick offers his program for re-establishing civil rights based upon the principles of liberty, property, and equality before the law. Throughout the book, Bolick's analysis is incisive and his writing is clear.

Eighteenth- and nineteenth-century civil rights leaders drew heavily upon the ideas of John Locke. Locke wrote that all people have a right to life and property, including property in themselves, and logically deduced the necessity of equal opportunity before the law. He, in effect, set the justification for a free society upon two planes: (1) the ethical notion of the individual's right to property and freedom of choice and (2) the political view of representative government to protect those rights.

This classical liberal concept of equal rights, based upon the right to life and property, made it impossible for slavery to continue unchallenged. The stage was set for the abolition movement.

Organized opposition to slavery in America had begun in the late 1600s, especially in New England and among the Quakers. The Revolutionary leaders documented their support for civil rights in the Declaration of Independence and the Constitution of the United States. Yet they did not eliminate the institution of slavery which was contrary to all they believed and fought to attain.

Bolick details the abolitionists' efforts to eradicate slavery and to educate the public in the classical liberal ideas which form the basis of civil rights. His analysis of this important period in civil rights history is concise and enlightening.

Early nineteenth-century abolitionists promoted several methods of education and manumission with limited success. William Lloyd Garrison became their leader, publishing his arguments in *The Liberator* and participating in the formation of the American Anti-Slavery Society. Regardless of method, the typical abolitionist's stand was upon his or her faith that all persons are created equal. The debate over slavery truly became a battle with lines drawn on moral absolutes.

Resorting to political means, abolitionists founded the Liberty Party in 1839. They met with difficulty because of their limited constituency and voting restrictions on blacks and, in 1848, many joined with the Free Soilers. By 1860, the political forum for the abolitionists

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had expanded and strengthened. The result was the Republican Party with Abraham Lincoln as its candidate.

The American Civil War, for all its bloodshed and destruction, ensured that equal rights for all citizens would be incorporated into the law of the land. Slavery was abolished officially in 1865 by the Thirteenth Amendment. Congress also enacted the Freedmen Acts to assist former slaves. The Civil Rights Acts of 1866 and 1871, according to Bolick, held to the original interpretation of civil rights for protection on the Federal and state levels. The Fourteenth Amendment banned discrimination by states; the Fifteenth Amendment ensured voting rights regardless of "race, color, or previous condition of servitude." These Amendments sought to remedy inadequacies in the law and to counter the Black Codes formulated in the South to subjugate the freed slaves after the war.

Stifled on one front, white racists responded by erecting economic barriers to black progress. The Supreme Court sanctioned this approach by taking a narrow view of civil rights in the famous *Slaughter-House Cases*. Various states soon contrived Jim Crow laws modeled after the earlier Black Codes.

The intellectual descendants of the original civil rights leaders were subsequently led by Booker T. Washington. Washington stressed the idea of black self-help, and asked only that the rights of Negroes be construed in the context of equality before the law. His critics, notably W. E. B. DuBois and Marcus Garvey, did not like what they considered his placation of white supremacists. Despite this infighting, the efforts of civil rights leaders succeeded in opening new opportunities for black Americans and culminated in the creation of the National Association for the Advancement of Colored People (N.A.A.C.P.) in 1909, formed expressly to secure equal rights for blacks.

The years of the World Wars and the Great Depression brought new challenges for the civil rights movement. Other minorities entered into civil rights controversies, most notably the Japanese in the 1944 case of *Korematsu* v. *United States*, which supported the incarceration of Japanese-Americans during World War II. This case reaffirmed the "reasonableness" criterion established in 1896 by *Plessy* v. *Ferguson*, which had sanctioned "separate but equal" laws. The states or federal government now could discriminate in the "public interest." In other words, the rights of United States citizens were conditional—determined by the partiality of the legislature and the courts. Legal paternalism was accepted and institutionalized.

The catchword of the twentieth century became "segregation," and two distinctive movements for black civil rights emerged. The traditional ideas were taken up by Martin Luther King and the N.A.A.C.P. Meanwhile, another pressure group developed, picking up some of the old separatist ideas advanced by Marcus Garvey in the last century. Characterized by notions of class conflict, collectivism, and forced economic reallocation, this new separatism was a militant and racist thorn in the side of equal opportunity. Nonetheless, the Civil Rights Act of 1964, the Twenty-fourth Amendment, and the Voting Rights Act of 1965, along with other changes in the 1960s, bolstered the legal and social foundations of civil rights.

Since the 1960s, however, we have witnessed a major alteration in the civil rights movement. Bolick calls the dramatic deviation a "revision" because it borrowed from the old school on the surface, but actually adopted the new separatist approach. The vocal new order calls for equality in result, collective identification, and a questionable perception of "rights" that has little or no relationship to individuals' rights. This is the status of the movement today.

The second part of the book addresses the contemporary civil rights scene and lays out a compelling plan for the future. Particularly noteworthy is Bolick's chapter on "The Necessity of Judicial Action," which contains his theories for returning to the original interpretation of equal rights in the courts. This chapter is especially interesting in light of recent controversies surrounding the Supreme Court that have brought out new questions as to the proper role and impartiality of that court.

On three points, however, I must disagree with the author. First, he advocates "Economic Liberty Acts" to be passed by legislatures on the state and Federal levels. These acts suppos-

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edly would promote entrepreneurship by prohibiting government intervention into economic activity. Second, he believes that inner-city areas should be set aside as "enterprise zones," a kind of capsulated capitalism. Third, he endorses a "voucher system" for parents to opt out of public schools and tax credits for supporters of children in private schools. These three suggestions are political remedies subject to the whim and caprice of politicians, and beg the question of truly principled action.

On the whole, however, I cannot speak too highly of this book. If you read between the lines, you realize that what we see and hear today is not the legacy of Dr. King. The loud and intimidating antics of some of today's civil rights leaders may overshadow this fact, but Bolick's message is clear when he concludes that "The challenge is for whites to learn the lessons of the past two decades; for blacks, to demand and exploit the opportunities that America's commitment to civil rights is intended to guarantee; and for all Americans, to be faithful to the ideals upon which this nation's claim to greatness is based." □

Mr. Helstrom is a member of the staff of The Foundation for Economic Education.

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Prepared by
Bettina Bien Greaves

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